New Brunswick Insurance Board

DECISION

IN THE MATTER:

Of a rate revision application for **PEMBRIDGE INSURANCE COMPANY**

With respect to automobile insurance rates for

PRIVATE PASSENGER VEHICLES

Written Hearing

Heard at Saint John, New Brunswick

PANEL:	Ms. Marie-Claude Doucet	Chair
	Mr. Jim Jessop	Member
	Ms. Elizabeth Turgeon	Member

Date of Written Hearing: January 31, 2018

Decision Rendered February 15, 2018

Summary

[1] Pursuant to subsection 267.5(1) of the *Insurance Act,* R.S.N.B., 1973 c. I-12, (the "Act") the New Brunswick Insurance Board (the "Board") convened a Panel of the Board to conduct a written hearing (the "Hearing") on January 31, 2018 at the offices of the New Brunswick Insurance Board, in Saint John. The purpose of the Hearing was to consider the rate revision application (the "Filing") submitted by Pembridge Insurance Company (the "Applicant" or "Pembridge") with respect to automobile insurance rates for private passenger vehicles (PPV) in New Brunswick. Pembridge is an insurance company duly licensed to write automobile insurance in New Brunswick.

[2] In compliance with subsection 19.71(3) of the *Insurance Act,* the Board provided to the Office of the Attorney General ("OAG") and to the Consumer Advocate for Insurance ("CAI"), all documents relevant to the Hearing. Pursuant to subsection 19.71(4) of the Act, the OAG and the CAI initially advised the Board of their intention to intervene. The OAG participated to the interrogatory process by submitting two rounds of questions to the Applicant.

[3] On January 16, 2018, the OAG notified the Board of its withdrawal as an intervenor to this matter. On January 18, 2018, the CIA also notified the Board of her discontinuance as an intervenor.

[4] For the purpose of the written hearing the Panel accepted the following exhibits as part of the Record as shown below:

EXHIBIT	DESCRIPTION	DATE
1	Pembridge Private Passenger Vehicle Rate Filing	Aug 29, 2017
2	Questions from NBIB	Sept 1, 2017
3	Questions from EY	Oct 5, 2017
4	Pembridge Response to NBIB	Oct 6, 2017

5	Pembridge Response to EY	Oct 13, 2017
6	EY Actuarial Review Summary	Nov 3, 2017
7	Written Interrogatories Round 1 from OAG	Dec 14, 2017
8	Pembridge Response to Interrogatories Round 1	Dec 22, 2017
9	Interrogatories Round 2 from OAG	January 4, 2018
10	Pembridge Response to Interrogatories Round 2	Jan 12, 2018
11	Pembridge Final Written Submission	Jan 23, 2018

[5] Following the hearing, on February 9, 2018, the Panel ordered the Applicant to adjust its overall indication for the impact of the combination of the following five (5) changes:

1) Apply adjustment factors of +1.77% for physical damage coverages (Property Damage (PD), Direct Compensation – Property Damage (DCPD), Collision (CL), Comprehensive (CM), Specified Perils (SP) and All Perils (AP)), +1.2% for Accident Benefits (AB), and +0.44% for Bodily Injury (BI) for experience prior to July 1, 2016 to account for the effect of the HST change;

2) Exclude the Facility Association Residual Market experience from its analysis;

3) Rely only on New Brunswick data for its trend analysis;

4) Amend its filing by modifying its fixed expense ratio to be 12.69%; and

5) Modify its filing in order to remove the catastrophe load provision of 1.00% from the Comprehensive coverage.

[6] The required changes as per above result in an overall indication of 37.90%, a decrease of 1.36% from Pembridge's prior indication of 39.26%.

[7] The Panel, after examining the evidence in its entirety, approves the rate change of **+8.05%** proposed by the Applicant.

[8] The approved rates will be effective on April 1, 2018 for new and June 1, 2018 for renewal business.

1. Introduction

[9] The Board is mandated by the Legislature with the general supervision of automobile insurance rates in the Province of New Brunswick. In order to fulfill that mandate, the Board exercises the powers prescribed by the Act. One key responsibility for the Board is to ensure that rates charged or proposed to be charged are just and reasonable. Under the Act, each insurer carrying on the business of automobile insurance in the province must file with the Board the rates it proposes to charge once every 12 months from the date of its last filing. An insurer must appear before the Board when :

a. The Insurer files for a rate change more than twice in a 12 month period, or

b. The Insurer files rates where the average rate increase if more than 3% greater than the rates charged by it within the 12 months prior to the date on which it proposes to begin to charge the rates, or

c. When the Board requires to do so.

Procedural History

[10] The Applicant filed a rate revision application for the PPV category on August 29 2017, proposing an overall average rate increase of 8.05%.

[11] The Board issued a Notice of Hearing on November 8, 2017 and convened a Panel of the Board to conduct a hearing on the matter. The Office of the Attorney General and

the Office of the Consumer Advocate for Insurance both provided notice of their respective intentions to intervene in the rate hearing.

[12] Prior to the Hearing, the OAG submitted two sets of interrogatories to the Applicant, to which answers were provided. The OAG however provided the Board with its notice to withdraw as an intervenor in this matter on January 16, 2018.

[13] On January 18, 2018, the CAI also informed the Board of its withdrawal as an intervenor.

[14] A pre-hearing written final submission was provided by the Applicant to the Board on January 23, 2018.

[15] Finally, the Panel held the written hearing on January 31, 2018.

2. Evidence and Positions of the Parties

Pembridge Insurance Company

[16] The Applicant's Filing forms the main portion of its submission and the evidence before the Panel.

[17] Pursuant to its mandate, the Board, upon receipt of the Filing, proceeded to investigate the Filing in order to determine whether the proposed rates are "just and reasonable".

[18] Pembridge presented a Filing to the Board with an overall indication of +39.26% and proposed to select an average rate change of 8.05% based on its first alternative indication. Following are the changes proposed to the existing rates by coverage:

Bodily Injury	+ 8.65%
Property Damage	+ 7.77%
Property Damage – Direct Compensation	+ 8.69%
Accident Benefits	+ 8.68%
Uninsured Auto (UA)	+ 0.00%
Collision (CL)	+ 7.62%
Comprehensive (CM)	+ 7.79%
Specified Perils	+ 7.84%
All Perils	*Included in CM/CL*
Total	***+ 8.05%***

[19] The rates contained in the Filing are produced assuming a target return on equity (ROE) of 12%, a 10.37% target return on premium (ROP) and a 1.70:1 premium to surplus (P/S) ratio. The proposed overall average rates would increase from the current of approximately $761.88 to approximately $823.22.

[20] The Applicant submits that the Filing was prepared utilizing sound actuarial methods and practices and that the assumptions contained therein are reasonable and that the Filing has been prepared in accordance with the filing guidelines issued by the Board.

Office of the Attorney General

[21] The OAG was provided with the Filing and all related documents. The OAG was also given the opportunity to query the Applicant through a written interrogatory process which provided for two rounds of interrogatory questions and answers. At the conclusion of the interrogatory process, the OAG discontinued its intervention and did not participate further in the hearing process. The interrogatory questions and answers were part of the Record before the Panel.

Consumer Advocate for Insurance

[22] The CAI was also provided with all the relevant documentation and had initially advised the Board of its intention to participate to this matter as an intervenor.

However, on January 18, 2018, the Board was informed of the CAI's discontinuance as an intervenor in this matter.

3. Analysis and Reasons

[23] The Panel has reviewed all of the written evidence before it, along with the submissions made by the Applicant.

[24] In the present matter, the Panel of the Board determines that Pembridge Insurance Company must amend some of the assumptions, calculations and methodology used in its Filing. The Applicant was therefore ordered to provide the Board with the calculation resulting from those amendments on February 9, 2018.

[25] The Panel addresses each issues individually as follows:

1) Adjustments

[26] Within the Record before the Board, it was noted by both the Board's consulting actuary as well as by the OAG's retained actuary, Ms. Paula Elliott of Oliver Wyman, that the Applicant was not compliant with the Board's filing guidelines in some of its assumptions and methodologies.

- ***Harmonized Sales Tax (HST)***

[27] In its Filing, the Applicant did not make any adjustment to prior historical claims experience to reflect the change in HST rate from 13% to 15% effective July 1, 2016. In the written interrogatory phase (Exhibit 7, page 1), the OAG suggested adjustment factors of +1.77% for physical damage coverages (PD, DCPD, CO, CM, SP and AP), +1.2% for AB and +0.44% for BI for experience prior to July 1, 2016.

[28] In its Final Submissions (Exhibit 11, page 2), the Applicant agreed that the adjustments factors provided by the OAG were reasonable and agreed the adjustment was necessary to reflect the effective HST rates.

[29] The Panel agrees with this concession and requires Pembridge to make the HST adjustments as proposed and agreed to by the Applicant.

- ***Inclusion of Facility Association Residual Market Experience***

[30] To the extent that Pembridge's own experience was not credible, the Industry data - provided by the General Insurance Statistical Agency (GISA), including Facility Association (FA)'s losses - was used as the complement of credibility. The Board's guidelines explicitly state that the Facility Association Residual Market (FARM) results should be excluded from the company's own experience. Similarly, the FARM experience should be excluded when industry-wide experience is used.

[31] In its Final Submission (Exhibit 11, page 2), the Applicant explained to the Board that the inclusion of FA's data was done inadvertently and agreed to remove the losses incurred on the FA residual market when calculating its adjusted loss cost.

[32] The Panel acknowledges that it was not the intention of Pembridge to include FA's losses and accepts the company's intended measure to adjust its loss cost removing FA's data.

2) Trend Selections

- ***Loss Cost Trends***

[33] The selection of loss trend rates requires the analysis of past data and the application of professional judgement in order to select trend rates for each coverage which in this case is achieved by separately selecting and then combining frequency and severity trend rates, representing past experience and future expected results.

[34] Further to a review of the Applicant's selected trends, the Panel identifies no issue with the general approach adopted by Pembridge, and finds its overall trend selection to be reasonable.

[35] It was, however, noted that for trend selection of some coverages, Pembridge has used the New Brunswick Industry data (for BI, PD, medical benefits and income replacement), as well as the Atlantic data for other smaller coverages (funeral benefits, death benefits, underinsured motorist and uninsured automobile).

[36] Section 4.b. of the NBIB's Filing Guidelines directs that the insurer's own data must be used to the extent that it is credible. It also directs that New Brunswick specific loss data for the filed category of insurance at the coverage level must be used.

[37] In its Final Submission (Exhibit 11, page 3), the Applicant proposed changing its industry trend selection to rely solely on New Brunswick experience in order to ensure compliance with Section 4.b. of the New Brunswick Insurance Board's Filing Guidelines.

[38] The Panel, in agreement with the Applicant, requires modification to rely only on New Brunswick data for the purpose of trend selection.

- ***Premium Trends***

[39] For the development of its premium trends, the Applicant chose to adopt IBC published rate group drift factors (incorporating VICC drift factors) as opposed to using its internal premium drift. This selection remains consistent with Pembridge's previous filing submissions. In its Final Submission (Exhibit 11, page 4), Pembridge explains that the company does not separately review its own vehicle rate group experience, but does have a premium trend exhibit based on onlevelled average premiums by coverage. Pembridge further submits that this not only reflects rate group drift but also other mix of business shifts.

[40] Pembridge finally submits that since loss trends are based on industry experience, there should be an alignment on the premium trends by using rate group drift factors (Exhibit 11, page 4).

[41] The Panel recognizes that the premium trend selection is an exercise of judgement and finds that the methodology adopted by Pembridge is reasonable in the absence of other information. Notwithstanding, the Panel opines that companies should use their own data for premium trends unless it provides the Board with support indicating that its rate group trend is similar to that of the industry. Consequently, for the purpose of future rate Applications, the Board will expect the use of the company's own experience to derive its rate group drift unless it provides the Board with the appropriate support demonstrating that their data is similar to used by VICC.

3) Health Service Levy Allocation as a Variable Expense

[42] The Applicant considered the allocation of the Health Service Levy (HSL) to be a variable expense. The OAG questioned the treatment of the HSL as a variable expense as opposed to a fixed expense. In its Submission (Exhibit 11, page3), the Applicant justifies the treatment of the HSL as a variable expense arguing that this expense is collected based on a percentage of premium.

[43] The Panel agrees with the Applicant that where the levy is collected as a percentage of the premium, it should be treated as a variable expense.

4) Expense

- ***Expense Exhibit***

[44] Prior to its Final Submission, the Applicant noticed an error with respect to the fixed expense ratio calculated for year 2016. The three-year average fixed expense ratio presented was 14.06%, while it should have been calculated to be 12.69%.

[45] The Panel orders the Applicant to make the necessary correction using 12.69% as the fixed expense ratio.

- ***Expense Ratio***

[46] The expense ratio used by the Applicant is based on both Pembridge and Pafco's data combined. The rational provided to the Board by Pembridge is that many expenses are shared by the two companies as both operate in the same channel of distribution and many of Pembridge's brokers also write Pafco business. In addition, other operations of the company, such as underwriting, also service both companies under the same leadership. The Applicant therefore submits that combining expenses of both Pembridge and Pafco is reasonable and provides more stable results for expenses.

[47] The Panel finds the methodology employed by the Applicant to calculate the expense ratio to be reasonable.

- ***Fixed Expense Allocation***

[48] The fixed expense component is assumed to vary only by the number of exposures as opposed to by premium. Pembridge argues that under such an assumption, the allocation to each exposure should be independent of the coverage purchased and that by allocating it only to mandatory coverages the same fixed expense is applied to each exposure. Furthermore, the Applicant submits that allocation to non-compulsory coverages would result in vehicles carrying more coverage being assigned greater fixed expense.

[49] The Panel is satisfied by the Applicant's rationale on its allocation of general expense ratio and finds it to be reasonable.

5) Catastrophe Loss Load

[50] The Applicant selects a catastrophe load of 1.0% for the comprehensive coverage and provides its justification for catastrophic loss provision based on Pembridge's historical accident experience for years 2007 to 2017. However, NBIB's Filing Guidelines, paragraph 4.b.4. provides that "*The Province of New Brunswick is rarely impacted by catastrophes affecting automobile insurance claim. The NBIB does not expect that there should be a loading for this*".

[51] The Panel is not satisfied by the evidence provided by Pembridge that the inclusion of a Catastrophe Load of 1.00% is justified. The Panel therefore requires the Applicant to remove this loading provision from its filing.

6) Complement of Credibility

[52] To the extent that a Company's own experience is not fully credible, the insurer must select a complement of credibility in order to be considered fully credible. Pembridge, lacking data to reach the full credibility standard, selected the Industry experience as the complement of credibility. In its interrogatory questions (Exhibit 10, page 3), the OAG raised concern with respect to Pembridge's selection of complement of credibility and questions the Applicant on its rationale for not selecting the experience of Allstate, its sister company, as the complement of credibility.

[53] In its answers to the OAG's interrogatory questions (Exhibit 8, page 3), Pembridge responded that the industry experience presents a larger source of data in relation to Allstate and Pembridge's experience and therefore provides more stability as the compliment. Furthermore, in its Final Submission, Pembridge explains that the market represents a better reflection of the company's current state and therefore finds that applying the industry experience as the complement of credibility to be more appropriate.

[54] The Panel agrees with the Applicant that the industry experience provides a more stable and appropriate complement of credibility in the circumstances and finds this selection reasonable.

7)Profit Provisions

[55] In the calculation of its overall rate level change need, Pembridge includes a profit provision targeting a ROE of 12%, a P/S ratio of 1.7 to 1, as well as a pre-tax return on investment (ROI) of 0.66% for cash-flow and 0.99% for surplus.

- ***Selection of pre-tax Return on Investment***

[56] The process of developing rates that are just and reasonable requires rate applications to account for the revenue received from sources other than directly from policyholders. One source of these funds is investment income that is received on surplus funds held by insurers. Generally, these surplus funds stem from two sources: short-term cash flow and accumulated equity (surplus) and are invested using different approaches, i.e. short-term and long-term respectively. Generally, the higher the overall investment return, the lower the overall rate indications.

[57] The Applicant prepared its Filing by selecting a pre-tax return on investments (ROI) of 0.66% for cash flow and 0.99% for surplus, varying by coverage (Exhibit 8, page 5). This ROI is assumed by the Applicant on the basis of an estimated return on a risk-free portfolio of investments. Pembridge explains that these rates are reflective of the use of risk-free rates given Pembridge bears the risk of its investments and not the policyholders. Furthermore, the Applicant emphasized that being as likely to realize negative returns, those should not be borne by policyholders (Exhibit 11, page 7) and argues that using safer investments, such as T-bills and government bonds, are more reasonable for determining returns on policyholder supplied funds.

[58] The Panel accepts Pembridge's selection on its rate of return to be reasonable.

- ***Selection of Premium to Surplus Ratio***

[59] The Applicant's indication applies an overall 1.7 to 1 P/S ratio varying by coverage. Pembridge supports this selection based on the 5-year average of Pembridge Canada Group's P/S ratio from the company Property and Casualty-1 (P&C), which suggests the business operated at an average ratio of 1.73:1 over years 2012 to 2016. The Applicant also points that the company has never reached a ratio of 2:1 during this five year period (Exhibit 11, page 6).

[60] In light of the evidence provided by the Applicant, the Panel finds the P/S ratio of 1.7:1 to be reasonable.

4. Decision

[61] For the reasons set out above, the Board finds the Applicant's Filing not to be just and reasonable in its entirety and therefore orders the following changes to be made:

1) Apply an adjustment factors of +1.77% for physical damage coverages (PD, DCPD, CO, CM, SP and AP), +1.2% for AB and +0.44% for BI for experience prior to July 1, 2016 to account for the effect of the HST change;

2) Exclude the Facility Association Residual Market experience from its analysis;

3) Rely only on New Brunswick data for its trend analysis;

4) Amend its filing by modifying its fixed expense ratio to be 12.69%; and

5) Modify its filing in order to remove the catastrophe load provision of 1.00% from the Comprehensive coverage.

[62] The impact of these changes will be to decrease the overall rate indications from an average increase of +39.26% to an average increase of +37.90%.

[63] The Applicant is ordered to incorporate changes to the rate application as set out in paragraph 61 above and is **approved to adopt the proposed average rate change of +8.05%.**

[64] The approved rates will be effective on April 1, 2018 for new and June 1, 2018 for renewal business.

Dated at Saint John, New Brunswick, on February 15, 2018

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Marie-Claude Doucet, Panel Chair
Chair, New Brunswick Insurance Board

WE CONCUR:

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Jim Jessop, Board Member

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Elizabeth Turgeon, Board Member