New Brunswick Insurance Board

DECISION

IN THE MATTER:
Of a rate revision application for the Sonnet Insurance Company
With respect to automobile insurance rates for
Private Passenger Vehicles

Hearing Date: February 25, 2020
Written Hearing

Held at Saint John, New Brunswick

PANEL:	Ms. Marie-Claude Doucet, LL.B.	Chair
	Ms. Heather Stephen	Member
	Mr. Georges Leger	Member

Applicant: **Sonnet Insurance Company**

Intervenor:	**Consumer Advocate for Insurance**	
	Ms. Michèle Pelletier, LL.B.	Consumer Advocate

Decision Rendered April 09, 2020

NBIB Reference 2019-222

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 (the "Panel") to conduct a Written Hearing (the "Hearing") on February 25, 2020 at the Office of the Board, in Saint John. The purpose of the Hearing was to consider the rate revision application (the "Filing"), requesting approval for an average rate increase of 50.3%, based on an indicated rate increase of 79.4% submitted by Sonnet Insurance Company (the "Applicant" or "Sonnet") with respect to automobile insurance rates for Private Passenger Vehicles ("PPV") in New Brunswick.

[2] In compliance with subsection 19.71(3) of the *Act,* the Board provided to the Office of the Attorney General ("OAG"), all documents relevant to the Hearing. This documentation was also provided to the Office of the Consumer Advocate for Insurance ("CAI"). Pursuant to subsection 19.71(4) of the *Act*, the OAG initially intervened and questioned the Applicant by way of written interrogatories. Following interrogatories, the OAG advised the Board of its intention to discontinue its intervention. The CAI did intervene in this matter and provided a written submission for the Panel's consideration.

[3] Following the Written Hearing, the Panel ordered the Applicant to provide revised overall indications resulting from the following combination of changes:

1) For Third Party Liability – Bodily Injury (TPL-BI):

    a. Modify the frequency trend at -6.3% per annum;

    b. Adjust the frequency pre-2013H2 by the scalar of +34.9%; and,

    c. Modify the severity trend to 5.0% per annum.

2) For TPL-Property Damage (TPL-PD) and Direct Compensation - Property Damage (DCPD):

    a. Modify the frequency trend to 0% per annum; and,

    b. Maintain the severity trend to 5.7% per annum.

3) For Collision:

   a. Modify the frequency trend to 0.6% per annum; and,

   b. Modify the severity trend to 1.8% per annum.

4) Regarding the input to the complement of credibility:

   a. Ensure that the Economical Mutual Insurance Company ("Economical") rate indications and net trends reflect the above-mentioned hearing decision.

5) For the credible indication, modify the approach as follows: credible indication = (w1 x Ind1) + (w2 x Ind2) + {(1 – w1 – w2) x Ind3)}, where:

   a. w1 is the weight based on Sonnet's claim counts;

   b. w2 is the weight based on Economical's claim counts;

   c. Ind1 is Sonnet's pure indication;

   d. Ind2 is Economical's indication adjusted for the difference in premium level between Sonnet and Economical; and

   e. Ind3 is the net trend adjusted for the difference in premium level between Sonnet and Economical.

[4] The required changes, as per above, result in a decrease to the Applicant's overall indication from 79.4% to 75.0%

[5] With regard to classification differentials, the Panel ordered the Applicant to provide an alternative proposal and its effect on the premium dislocation. The Applicant put forward the following alternative:

1) Cap the proposed changes in differentials for all rating variables (other than minor/major/serious convictions, at fault accidents, cancellations for non-payment of premiums and conviction-free) at +/- 10%.

2) Balance back the base rates to achieve an overall rate change of +50.3%.

[6] The Panel, after examining the evidence and submissions, determines that the indication proposed by the Applicant must be modified.

[7] The Applicant is ordered to incorporate changes to the Filing as noted in paragraph [3] above and is **approved to adopt the proposed average rate change of 50.3% and the alternative proposed differentials as outlined in paragraph [5].**

[8] The approved rates will be effective on April 16, 2020 for new business and September 1, 2020 for renewal business.

Exhibits

[9] In the Hearing process, the Panel accepted the following exhibits as part of the Record of Hearing:

EXHIBIT	DESCRIPTION	DATE
1	Sonnet Original Private Passenger Vehicles Rate Filing	August 13, 2019
2	Round 1 Questions from KPMG	August 23, 2019
3	Round 1 Response to KPMG	August 29, 2019
4	Round 2 Questions from KPMG	September 9, 2019
5	Round 2 Response to KPMG	September 13, 2019
6	Round 3 Questions from KPMG	September 23, 2019
7	Round 3 Response to KPMG	October 1, 2019
8	Round 4 Questions from KPMG	October 4, 2019
9	Round 4 Response to KPMG	October 7, 2019
10	KPMG Actuarial Review Summary	October 18, 2019
11	Round 1 Questions from OAG	December 6, 2019
12	Round 1 Response to OAG	December 13, 2019
13	Round 2 Questions from OAG	January 3, 2020
14	Round 2 Response to OAG	January 10, 2020
15	Correspondence from OAG to Board	January 22, 2020
16	Final Written Submission from CAI	January 23, 2020
17	Final Written Submission from Sonnet	January 24, 2020
18	Board’s Request for Information	February 27, 2020
19	Sonnet’s Response to Board’s Request	March 6, 2020
20	Sonnet’s Updated Response to Board’s Request and Alternative Proposal	March 10, 2020
21	Sonnet’s Updated Response to Board’s Request and Alternative Proposal	March 13, 2020
22	Board’s Request for Information	March 20, 2020
23	Sonnet’s Response to Board Request	March 26, 2020

1. Introduction

[10] 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 at least 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 is 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 it to do so.

Procedural History

[11] The Applicant filed a rate revision application for the PPV category on August 13, 2019. The original overall indication of the Filing was 78.9% and the Applicant sought an overall average rate increase of 50.3%.

[12] Following the Board's consulting actuaries' questions, the Applicant submitted an Amended Filing on September 13, 2019, increasing its rate indication to 79.4% and the proposed selection remaining at 50.3%.

[13] The Board issued a Notice of Hearing on October 24, 2019 and convened a Panel of the Board to conduct an Oral Hearing on the matter. The OAG and the CAI both provided notice of their respective intentions to intervene in the Hearing.

[14] Prior to the Hearing, the OAG submitted two sets of interrogatories to the Applicant, to which answers were provided.

[15] On January 22, 2020, the OAG notified the Board of its decision to discontinue its intervention.

[16] Pre-hearing written submissions were provided by the Applicant and the CAI to the Panel.

2. Evidence and Positions of the Parties

Sonnet Insurance Company

[17] The Applicant, which constitutes the only fully online automobile insurance company, is part of the Economical Insurance group. At the time of the present Filing, Sonnet neared three years of operation in the New Brunswick market.

[18] The Applicant's book of business is mostly composed of inexperienced drivers, with an over-representation of these having the First Chance Discount, notably those with no driver training. Sonnet's rate for these drivers is currently underpriced. As a result, the Applicant has a disproportionate share of these risks compared to its sister company, Economical, as well as to the entire New Brunswick market. Consequently, the Applicant incurred a severe disequilibrium between drivers licenced less than 20 years and those with 21+ years of driving experience.

[19] The Applicant submits that the main objective of its proposed pricing strategy is to address its overly competitive position for the inexperienced drivers. Sonnet also wants to decrease the overall variability of their competitive position in order that they are no longer overexposed to new business for any single year licenced demographic.

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

[21] While the Applicant's indications rose slightly during the interrogatory process, it maintained its average rate change selection of +50.3%.

[22] The following table summarizes the amended indicated and proposed rate changes by coverage:

Coverage	**Indicated**	**Proposed**
Bodily Injury (BI)	96.9%	63.40%
Property Damage (PD)	Incl. with BI	Incl. with BI
Property Damage – Direct Compensation (DCPD)	102.1%	61.01%
Accident Benefits (AB)	53.2%	36.39%
Uninsured Auto (UA)	14.2%	9.49%
Collision	51.4%	30.50%
Comprehensive	109.9%	71.80%
Specified Perils (SP)	80.9%	52.44%
Underinsured Motorist (UM) – SEF44	-17.4%	0.00%
Total	79.4%	50.31%

[23] The rates contained in the Filing are calculated assuming a target return on equity (ROE) of 12%, a pre-tax investment rate on cash flow (ROI) of 2.07%, an investment rate on capital of 1.73%, and a 2:1 premium to surplus ratio. Proposed average rates would increase from the current average premium of approximately $1,079 to approximately $1,623.

[24] In its Final Submission made to the Board, the Applicant provided the following reasoning for its proposed rate increase:

> With this filing, Sonnet Insurance Company ("Sonnet") applied for changes to its current rates for private passenger vehicles ("PPV") that vary by coverage and result in an overall all-coverages combined increase of 50.3. This proposal is supported by an overall rate indication of +79.4%.
>
> Following the decision of the New Brunswick Insurance Board provided on January 20, 2020, Economical Mutual Insurance Company ("Economical") has been directed to adopt alternative loss trend rates. Sonnet will adopt the same loss trend rates as directed by the Board for Economical. As presented in the response to IR#2, the impact on Sonnet's indication of adopting these loss trend rates is to reduce the indication from +79.4% to +78.5%.
>
> [Exhibit 16, page 633 of the Record]

[25] The Applicant submits that the Filing was prepared utilizing sound actuarial methods and practices and that the assumptions contained therein are reasonable. Further, it says that the Filing has been completed in accordance with the Filing Guidelines issued by the Board.

Office of the Attorney General

[26] 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. The interrogatory questions and answers are part of the Record before the Panel.

[27] At the conclusion of the second round of the interrogatory process, the OAG discontinued its intervention and did not participate further in the hearing process. In its discontinuation correspondence to the Board, the OAG indicated that its alternative estimate of the indicated rate level change is essentially the same as the Applicant's proposal, and as a result, the OAG made the decision to discontinue its intervention in this matter.

Consumer Advocate for Insurance

[28] The CAI submitted that the rate increase requested by the Applicant is neither just nor reasonable but that she did not have access to an actuary to challenge the proposal as submitted by the Applicant.

[29] In her written submission, the CAI submitted as follows:

> Sonnet is operating on-line only and thus, is not a typical insurer. They are projecting 37.1% as total expenses. Last year, they were projecting 29 %. What is the basis for this significant increase? Is it reasonable? We submit that it is not. If Sonnet decide to spend more on marketing, the consumers should not be paying for that expense.
>
> The Office of the Consumer Advocate for Insurance maintains that the return on equity should follow the market and should be aligned with other provinces. Is a return of 12% is just and reasonable in the current market? Are consumers getting that rate on their investments? We must remember that ROE has a massive impact on premiums. We also submit that insurers doing business in other Atlantic provinces and Ontario are not getting a ROE of 12%. We submit that the Board, when deciding what is just and reasonable, must also interpret what is just and reasonable in regards of the consumers of New Brunswick. We certainly don't want consumers driving without insurance because their premiums are unaffordable. Insurance is mandatory. Driving a car in New Brunswick is also mandatory. We need to drive to and from emergency room, doctor's appointment, school, workplace every day.
>
> We submit that the proposed increase is non-reasonable and is neither just nor reasonable.
>
> [Exhibit 16, pp. 629-630 of the Record]

3. Analysis and Reasons

[30] The Panel has reviewed all of the written evidence before it, including interrogatories and written submissions.

[31] As set out below in more detail, on some issues, the Panel accepted the Applicant's evidence as satisfying its evidentiary burden of just and reasonable. On other issues, the Panel has accepted alternative positions as it found that the Applicant failed to meet its burden of proof.

[32] In the present matter, the Panel of the Board determines that the Applicant must amend some of the assumptions, calculations and methodologies used in its amended Filing. The Applicant was consequently ordered to provide the Board with additional information prior to the final determination of this Application.

[33] The Panel addresses each of the material issues individually below:

1) Selected Loss Trend Rates

[34] The selection of loss trend rates requires the analysis of past data and the application of professional judgement in order to select trend rates representing past experience and future expected results for each coverage. Loss cost projection factors are then selected based on the trend analysis.

[35] In its loss trend analysis, the Applicant fully relied on the selected trend rates of its affiliated company, Economical. The Applicant undertook to adopt the loss trends approved by the Board on January 20, 2020 for Economical. This adoption decreased the Applicant's overall indication from 79.4% to 74.7% The Board finds this change to be appropriate.

2) Credibility

a. Credibility Formula

[36] The Applicant proposed a nested credibility formula to combine Sonnet data with Economical data and net trends. The OAG's interrogatory questions highlighted a common alternative 3-way credibility formula. While both approaches can be acceptable, the Panel prefers the more common 3-way credibility approach, as it is simpler to understand and easier to track. While

the nested method could be reasonably adopted in some circumstances, the Panel is not persuaded that the approach has significant technical advantages over the alternative formula, based on the available record.

b. Complement of Credibility

[37] To the extent that the Applicant's own data is not fully credible, it must consider a relevant complement of credibility for the data. The Applicant's approach was to start with their own data, blended with the indication from Economical after adjusting for differences in premium level between Economical and Sonnet. The third complement is the net trend adjusted for the differences in premium level between the two companies. As part of its interrogatories, the OAG put forward the unadjusted net trend as an alternative to the third complement. The Applicant supplemented the following justification against the unadjusted net trend:

> However, the approach suggested is flawed, as the underlying assumption of purely using the net trend as the complement of credibility, that Sonnet's current rates are adequate is not reasonable. Rather, the third component of the equation should also recognize Sonnet's current rate inadequacy, otherwise this will result in an understatement of the complement of credibility.
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> [Exhibit 12, p. 564 of the Record]

[38] While the Panel understands the desirable criterion for an unbiased complement of credibility, the Panel also considered that the complement of credibility would exhibit characteristics that may reasonably be expected to be similar to the insurer's experience. In these particular circumstances, the Panel accepts the Applicant's choice as for third complement of credibility.

[39] In sum, regarding credibility, the Panel orders the Applicant to adopt the 3-way credibility formula, and the Applicant's adjusted complement. This adoption increases the Applicant's overall indication from 74.7% to 75.0%.

3) Expenses

[40] The Applicant assumed a fixed expense ratio of 34.1%, which reflects the projected expenses for 2021, based on its 2019 financial plan. This is a notable increase from the fixed expense ratio assumption of the previous year's filing of 26%, which reflected its estimated projected expenses for 2021, based on its 2018 financial plan. The Applicant explained that the changes between the two financial plans reflect the considerable changes in its recent experience. Sonnet is part of a small group of insurers seeking to attract and serve customers in a non-traditional way. Being solely internet based, Sonnet incurs significant marketing expenses.

[41] According to its 2019 financial plan, the Applicant projected a decrease in its current fixed expense ratio to reach 34.1% by 2021, which it deemed to be more indicative of its long-term level. Thus, the Applicant elected to use its updated 2021 fixed expense ratio projection, based on the 2019 financial plan, to determine its rate indication. For the purpose of reviewing the reasonableness of the Applicant's approach, the Panel considered the effect of strictly matching costs and revenue, by reviewing the Applicant's fixed expense projection for 2020. That alternative approach would have led to an even higher expense ratio of 39.4%. The Panel concludes that the Applicant provided sufficient evidence to support the use of 34.1% as its fixed expense ratio assumption.

[42] The Applicant also selects 11% as its provision for Head Office expenses. It was noted that Economical used only 5.1%. The Applicant provided the following rationale to support its assumption regarding the Head Office expenses:

> The allocation of Head Office expenses to Sonnet is done by the method of Activity-Based Costing, whereby costs associated with Head Office Functions (HR, Technology, Finance, Actuarial, etc.) are allocated to Sonnet based on the expected resources and time spent by each of those Functions on Sonnet.
>
> It would not be appropriate to compare Head Office expenses as a percentage of premium between Economical and Sonnet, nor is it reasonable to assume the same percentage allocation based on premium between Economical and Sonnet because the underlying components of Head Office Expenses allocated to Sonnet would be different to Economical.

> There are a number of Functions, where the proportional allocation to Sonnet would be larger than the allocation to Economical.
>
> […]
>
> Ultimately, Head Office expense is a Fixed Expense and therefore, independent of premium. As explained above, the dollar amount of Head Office expense associated with a number of Head Office Functions are similar to or larger for Sonnet than Economical. Since Sonnet's current and future expected premium is less than Economical's, this results in the Head Office expense as a percentage of gross earned premium being more than double for Sonnet compared to Economical.

[Exhibit 14, pp. 599-600 of the Record]

[43] The Panel considered the material differences between the expenses that would be incurred by the two companies and finds the Applicant's justification for Head Office expenses ratio of 11% to be reasonable.

4) Selection of Return on Equity

[44] The CAI argued that a 12% target ROE is higher than what is allowed in other Atlantic provinces and will result in unreasonably high premiums.

[45] The CAI suggests that it is neither fair nor reasonable to allow New Brunswick policyholders to pay rates based on this target ROE.

[46] There was no evidence before the Panel that challenged the reasonableness of a 12% target after-tax ROE. While other regulators may arrive at a different conclusion in the specific circumstances of their own jurisdictions, this Panel is satisfied that a target after-tax ROE of 12% is reasonable in the circumstances of this application, and in light of the current market conditions. The OAG had requested a calculation of the effect on indications of a 1% decrease in target ROE; the result was a minimal 0.4% reduction to the overall rate indication.

[47] The Panel however reiterates that there is no benchmark for target ROE in New Brunswick and that every applicant’s target will be assessed on a case-by-case basis.

5) Differentials

[48] During the Hearing, the Panel also took note that the Applicant proposed significant changes to the differentials applied across various rating variables, notably to the territories, years licensed, convictions (minor, major and serious), at-fault accidents and cancellations for non-payment of premium. To select the proposed differentials, the Applicant overlaid the results of its Generalized Linear Model with competitive considerations and business requirements to address over-representation of particular risks in its portfolio. At first glance, the proposed differentials caused concern to the Panel, as to whether the rates would be just and reasonable across the various groups of policyholders. In addition to this concern, the Panel recognizes that the impact of the proposed changes for some groups would cause "rate shock," as an individual rate could increase in some instances by more than 100%.

[49] The Panel recognizes that the Applicant entered the New Brunswick market at a significantly underpriced level and has continued to carry rate inadequacy from inception up to present. As a result, many of the Applicant’s policyholders will now face significant rate increases. While the Panel recognizes the negative financial impact that the proposed rate change may have on many of the Applicant’s policyholders, it wants to emphasize that these policyholders have benefited from lower automobile insurance premiums over the past three years. They have paid much lower rates than they would have had the Applicant’s automobile insurance product been appropriately priced.

[50] Overall, the Panel finds that the proposed differentials are generally sensible, but orders that the individual impacts be mitigated. The Board ordered the Applicant to provide a mitigating proposal that caps the proposed changes in differentials for all rating variables (other than minor/major/serious convictions, at fault accidents, cancellation for non-payment of premiums

and conviction-free). The rate changes are to be capped at +/- 10% and balanced back the base rates to achieve an overall rate level change of +50.3%.

4. Decision

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

1) For TPL-BI:

   a. Modify the frequency trend at -6.3% per annum;

   b. Adjust the frequency pre-2013H2 by the scalar of +34.9%; and,

   c. Modify the severity trend to 5.0% per annum.

2) For TPL-PD and DCPD:

   a. Modify the frequency trend to 0% per annum; and,

   b. Maintain the severity trend to 5.7% per annum.

3) For Collision:

   a. Modify the frequency trend to 0.6% per annum; and,

   b. Modify the severity trend to 1.8% per annum.

4) Regarding the input to the complement of credibility:

   a. Ensure that the Economical rate indications and net trends reflect the above-mentioned hearing decision.

5) For the credible indication, modify the approach as follows: credible indication = (w1 x Ind1) + (w2 x Ind2) + {(1 – w1 – w2) x Ind3)}, where:

a. w1 is the weight based on Sonnet's claim counts;

b. w2 is the weight based on Economical's claim counts;

c. Ind1 is Sonnet's pure indication;

d. Ind2 is Economical's indication adjusted for the difference in premium level between Sonnet and Economical; and,

e. Ind3 is the net trend adjusted for the difference in premium level between Sonnet and Economical.

[52] The impact of these changes was calculated at the Panel's request in the Applicant's Summary of Indicated Average Rate Level Changes Using Alternate Assumptions of February 27, 2020, decreasing the Applicant's rate indication to an average increase of 75.0%.

[53] With regard to proposed differential, the Panel also orders the Applicant to

1) Cap the proposed changes in differentials for all rating variables (other than minor/major/serious convictions, at fault accidents, cancellations for non-payment of premiums and conviction-free) at +/- 10%.

2) Balance back the base rates to achieve an overall rate change of +50.3%.

[54] The Applicant is ordered to incorporate changes to the rate application as set out in paragraphs [51] and [53] above and is **approved to adopt the proposed average rate change of 50.3% as well as the alternative proposed differentials as outlined in paragraph [54]**.

[55] The approved rates will be effective on April 16, 2020 for new business and September 1, 2020 for renewal business.

Dated at Saint John, New Brunswick, on April 09, 2020.

Marie-Claude Doucet, Panel Chair
New Brunswick Insurance Board

WE CONCUR:

Heather Stephen, Board Member

Georges Leger, Board Member