# New Brunswick Insurance Board

# DECISION

IN THE MATTER:
Of a rate revision application for the Facility Association
With respect to automobile insurance rates for
***Private Passenger Vehicles***

Written Hearing by videoconference held:

September 23, 2020
**Written Hearing**

| | | |
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| **PANEL:** | Ms. Marie-Claude Doucet, LL.B. | Chair |
| | Ms. Francine Kanhai | Member |
| | Ms. Elizabeth Turgeon, LL.B. | Member |

**APPEARANCES:**

**Applicant:** **Facility Association**

Decision Rendered: October 27, 2020

## Summary

[1] The Applicant, Facility Association, (the "Applicant" or "FA") filed a rate revision application (the "Filing"), requesting approval for a proposed average rate change of 0.0%, based on an indicated average rate increase of 13.5% for automobile insurance rates for Private Passenger Vehicles (PPV) in New Brunswick.

[2] 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" or "NBIB") convened a Panel of the Board (the "Panel") and conducted a written hearing (the "Hearing") on September 23, 2020.

[3] Both the Office of the Attorney General ("OAG") and the Consumer Advocate for Insurance ("CAI") were notified of the Hearing, but both declined the opportunity to intervene.

[4] On September 23, 2020, following the Hearing, the Panel ordered the Applicant to provide revised overall and individual coverage indications resulting from the following:

*While maintaining the premium-to-surplus ration of 2:1, modify the ROI 2.26%, which relies on*

a. *The proportion of government bonds versus corporate bonds as reported in MSA Researcher, B04 - Total Canadian Property Casualty Industry (Ex ICBC-SAF, Ex Lloyd's), page 40.22 as at 2019.4 (YTD).*
b. *Bank of Canada selected marketable bonds average yields for 1-3-year, 3-5 year, 5-10 year and over 10 year as at December 30, 2019;*
c. *Bank of Canada selected treasury bill yields for 3 months as of December 30, 2019;*
d. *Corporate bonds nominal yield to maturity compounded semi-annually as at December 31, 2018 (as available in the CIA Report on Canadian Economic Statistics 1924 – 2018: Final Release – Tables or equivalent sources); and*
e. *Investment expenses at 0.15%*

[5] The requested changes resulted in decreased average rate indications as detailed in the table at paragraph 13 below. This information was considered by the Panel prior to rendering this decision.

[6] The Panel, after examining the evidence, determines that the Filing submitted by the Applicant must be modified. The Applicant is ordered to incorporate changes to the Filing as noted in paragraph [4] above and is approved to adopt the proposed average rate change of 0.0% for the reasons set out herein.

[7] The approved rates will be effective on March 1, 2021 for new business and March 1, 2021 for renewal business.

## Exhibits

[8] In the Hearing process, the Panel accepted the following exhibits from the Applicant as part of the Record as shown below:

| EXHIBIT | DESCRIPTION | DATE |
|---|---|---|
| 1.A | Original Filing Part 1.A | April 24, 2020 |
| 1.B | Original Filing Part 1.B | April 24, 2020 |
| 1.C | Original Filing Part 1.C | April 24, 2020 |
| 2 | Round 1 Questions from KPMG | May 8, 2020 |
| 3 | Round 1 Questions from NBIB | May 13, 2020 |
| 4 | Round 1 Response to KPMG | May 21, 2020 |
| 5 | Round 1 Response to NBIB | May 21, 2020 |
| 6 | Round 2 Questions from KPMG | June 1, 2020 |
| 7 | Round 2 Response to KPMG and Amendment | June 4, 2020 |
| 8 | Round 2 Questions from NBIB | June 12, 2020 |
| 9 | Round 2 Response to NBIB | June 15, 2020 |
| 10 | KPMG Actuarial Review Summary | June 19, 2020 |

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| 11 | Round 3 Questions from NBIB | July 16, 2020 |
| 12 | Round 3 Response to NBIB | July 22, 2020 |
| 13 | Letter Submission from FA | August 17, 2020 |

# 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 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

[10] The Applicant filed this Application for the PPV category on April 24, 2020. The original overall indication of the Filing was 13.5% and the Applicant sought an overall average rate change of 0.0%.

[11] Though the proposed rate change was 0.0% which is below the legislative threshold that triggers a hearing, the Board exercised its authority to hold a hearing in the circumstances of this Filing as FA is the market of “last resort” and consumers placed there will have no other insurance options. The Board issued a Notice of Hearing on July 23, 2020 and convened a Panel to conduct the Hearing on the matter. Both the OAG and the CAI declined to intervene.

[12] Prior to the Hearing, the Board and its consulting actuaries, KPMG, delivered five rounds of questions in total to the Applicant, to which answers were provided. The Applicant delivered a final written submission prior to the Hearing.

## 2. Evidence and Positions of the Parties

**Facility Association**

[13] The Applicant presented its Filing to the Board with an overall original indication of +13.5% and proposed to select an average rate change of 0.0%. The following sets out the initial indicated changes to the existing rates by coverage, along with the revisions provided on September 25, 2020 as requested by the Panel:

| | Initial indication | Revised indication |
|---|---|---|
| Bodily Injury (TPL-BI | + 15.9% | +11.0% |
| Property Damage (TPL-PD) | + 15.9% | +11.0% |
| Property Damage – Direct Compensation (DCPD) | + 13.5% | + 8.4% |
| Accident Benefits (AB) | + 1.5% | -2.6% |
| Uninsured Auto (UA) | + 5.9% | +1.5% |
| Collision | + 18.3 % | +16.5% |

| | | |
|---|---|---|
| Comprehensive | + 10.5% | +8.7% |
| Specified Perils (SP) | + 7.4% | +5.7% |
| Underinsured Motorist (UM) – SEF44 | +3.8% | -1.2% |
| **Total** | **+ 13.5%** | **+9.4%** |

[14] Both in the Filing and after the requested revisions, the Applicant proposed to make no changes to its current rates.

[15] The indicated rates contained in the initial Filing are estimated assuming a target return on equity (ROE) of 12%, an implied ROE of 0.40%, a pre-tax investment rate on cash flow (ROI) of 1.31%, an investment rate on capital of 1.31% and a 2:1 premium to surplus ratio.

[16] In its Final Submission made to the Panel, the Applicant provided the following reasoning for proposing a 0.0% change to rates in face of an average indicated rate increase of 13.5%:

> As you are aware, Facility Association filed for 0% change for PPV and Taxi business in New Brunswick. This was a conscious and deliberate decision made by the Facility Association Board in light of the impact the pandemic has had on the broader economy and the financial pressures that families and individuals have endured. …
>
> …While we understand, this decision may place Facility Association's rates in direct competition with standard market rates on a short- term basis, a rate increase in not appropriate at this time. [Record, p. 889]

## 3. Analysis and Reasons

[17] The Panel has reviewed all of the written evidence before it including the Applicant's submission.

[18] The Filing was reviewed and found to be compliant with the Board's Filing Guidelines as well as any applicable information bulletins. The overall methodology employed in the rate filing,

prepared by the Applicant's actuary who is a Fellow of the Canadian Institute of Actuaries, follows generally accepted actuarial approaches including methodologies, data, assumptions and judgment. With the exception of the ROI analysis, the Panel accepted the Applicant's evidence as satisfying its evidentiary burden that the rates proposed to be charged are just and reasonable in all of the circumstances.

[19] The Panel determines that FA must modify some of the assumptions, calculations and methodology related to ROI, as requested on September 23, 2020. The requested revisions were provided on September 25, 2020.

[20] The Panel addresses each of the substantive issues individually below:

### *A. Loss Trends*

[21] The selection of appropriate loss trends require the analysis of past data and the application of professional judgment. For the majority of the trend selections, the Applicant relied upon methodologies and assumptions that had been approved by the Board in the prior filing. However, there were some trend assumptions and/or methodologies that were not consistent with the prior filing as discussed below.

#### (a) Accident Benefits

[22] The Applicant has changed its methodology for the loss trend analysis for Accident Benefits (AB). In this Filing, FA has split AB coverage into sub coverages: Medical Expenses, Disability Income, Death Benefits and Funeral Expenses – each with its own individual trend.

[23] In considering the reasonableness of this approach, the Panel noted that the differentiation would facilitate detection of specific types of changes, but would also split the already limited data into smaller data sets, with much more volatility.

[24] At the request of the Board's actuaries, KPMG, the Applicant performed sensitivity analysis to determine the impact upon indicated rates if the prior methodology had been used. The impact upon the AB coverage, and on the overall indicated rate, is a negligible +0.1 % point. The Panel is satisfied that the approach to consider more granular data is reasonable, even though data is limited, particularly in light of the minimal impact on indicated rates.

[25] With respect to one of the new sub-coverages, Medical Expenses (ME), the modelling resulted in an R-squared value that could indicate a sub-optimal goodness of fit. When questioned, the Applicant explained its trend modelling process and practice of testing various competing models while considering other factors. The Applicant submitted that the severity model is a good fit considering the p-values and the inspection of residuals. As part of its trending process, the Applicant also assessed the reasonableness of the combined frequency and severity models as a whole and considered the resulting ME loss cost trend as appropriate. Based on the response to the inquiry, the Panel is comfortable with the validity of the modelling, including the introduction of the scalar to account for the change in the most recent data. While not tied to an external event, the singular scalar placed at a one-time shift in the data is appropriate in this circumstance and the Panel is satisfied that there is little risk of overfitting.

[26] Another one of the sub-coverages is Funeral Expenses (FE), a coverage with very little data. Not surprisingly, with such sparse data, the proposed model has little predictive value. Given the low goodness of fit statistics, a sensitivity analysis was performed to consider the effect of a 0% trend, rather than the indicated -1.7%. The sensitivity analysis concluded that this change would have no impact on the indicated rate and the Panel accepted the Applicant's loss cost trend for FE at -1.7%.

**(b) DCPD**

[27] With respect to the frequency trend for Direct Compensation coverage, the Panel noted that the R-squared for the Applicant's modelling could indicate a sub-optimal goodness of fit. In response to questioning related to that modelling, the Applicant provided additional support for the reasonableness of their modelling, concluding:

> FA believes that the selected DCPD frequency model is a good parsimonious fit with all coefficients being statically significant (p-value< 5.0%), and the small $R^2$ driven by coverage volatility and the recent 2004 introduction of DCPD. FA believes the combined selected DCPD frequency and severity models appropriately model the DCPD loss costs. [Record, p. 654]

[28] The residual graphs and other considerations used by the Applicant to assess the modelling, and the examination of loss cost trends as a whole, satisfy the Panel that the frequency trends adopted for DCPD are reasonable. The Panel also noted that the DCPD loss cost trends are moving in tandem with the related collision coverage loss cost trends.

**(c) Collision**

[29] For the Collision coverage, the Applicant selected frequency and severity trends of +3.0% and +4.5% respectively. KPMG questioned the Applicant on the rationale of a separate trend commencing at 2013-H2. On review, it was noted that the removal of the indicator that separates post-2013 trend would impact the indicated rate levels. The statistical measures derived from the models are acceptable, and the inspection of the residual plots indicates a sensible approach in this circumstance. Additionally, the Panel is of the view that the use of the most recent five years of data is a reasonable approach given the short-tail nature of this coverage. The trend from the 2013 period forward is accepted.

**(d) Comprehensive**

[30] For the Comprehensive coverage, the Applicant selected a severity trend of +2.9%. KPMG questioned the Applicant on the rationale of a separate trend commencing at 2016-H2. On review, it was noted that the removal of the indicator that separates post 2016-H2 trend would increase the indicated rate levels. The statistical measures derived from the models are acceptable, and the inspection of the residual plots indicates a sensible approach. The trend from the 2016 period forward is accepted in this circumstance.

***B. Fixed Expenses – Auto plus and MVR***

[31] The Applicant's Filing adopted an assumption for fixed expenses at 4.91 % of premium. Fixed expenses include several individual expenses, including the costs of obtaining driver record abstracts, which alone accounts for 2.91% of the 4.91%. This assumption is estimated from actual expenses incurred for obtaining the following abstract reports:

a. AutoPlus reports to obtain new business applicant's insurance policy and claims history (per vehicle basis);
b. Motor vehicle reports for up to date information related to individual drivers for both new business and renewals.

[32] The sample data used by FA to derive the assumption of 1.1 drivers per private passenger vehicle, which underlies the 2.91%, is based on a survey from 5 years ago. It understood that the average number of drivers per vehicle rarely changes, however the study is considered outdated. FA has committed to update the sample on the number of drivers per vehicle data, which is favorably noted by the Panel. While the data has no impact for this year in light of the proposed rate change of 0.0%, it is anticipated that updated data for this analysis will serve FA well in considering this factor for future filings.

### *C. <u>Selection of pre-tax Return on Investment</u>*

[33] The process of developing rates that are just and reasonable requires Applicants 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.

[34] The Applicant prepared its Filing by selecting a pre-tax return on investments (ROI) of 1.31% for cash flow and surplus. This ROI is assumed by the Applicant on the basis of an estimated return on a risk-free portfolio of investments.

[35] In FA's prior filing, following a hearing, that panel concluded it would be appropriate to select an ROI consistent with the insurance industry's actual mix of bond yield rates based on the distribution of such investments as compiled by MSA Research. This approach remains the preferable and most reasonable approach to FA's ROI assumptions.

[36] As requested by this Panel on September 23, 2020, the Panel directs the Applicant to modify its ROI, maintaining a 2:1 premium to surplus ratio, such that its relies on:

a. The proportion of government bonds versus corporate bonds as reported in MSA Researcher, B04 – Total Canadian Property Casualty Industry (Ex ICBC-SAF, Ex Lloyd's), page 40.22 as at 2019.4 (YTD);
b. The Bank of Canada selected marketable bonds average yields for 1-3 year, 3-5 year, 5-10 year and over 10 year as at December 30, 2019;
c. The Bank of Canada selected treasury bill yields for 3 months as at December 30, 2019;
d. Corporate bonds nominal yield to maturity compounded semi-annually as at December 31, 2018 (as available in the CIA Report on Canadian Economic Statistics 1924-2018: Final Release – Tables or equivalent sources); and
e. Investment expenses at 0.15%.

[37] Based on the above, the Panel orders the Applicant to use an assumed ROI of 2.26%.

## 4. Decision

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

1) While maintaining the premium-to-surplus ratio of 2:1, modify the ROI 2.26%, which relies on:
    a. The proportion of government bonds versus corporate bonds as reported in MSA Researcher, B04 – Total Canadian Property Casualty Industry (Ex ICBC-SAF, Ex Lloyd's), page 40.22 as at 2019.4 (YTD);
    b. The Bank of Canada selected marketable bonds average yields for 1-3 year, 3-5 year, 5-10 year and over 10 year as at December 30, 2019;
    c. The Bank of Canada selected treasury bill yields for 3 months as at December 30, 2019;
    d. Corporate bonds nominal yield to maturity compounded semi-annually as at December 31, 2018 (as available in the CIA Report on Canadian Economic Statistics 1924-2018: Final Release – Tables or equivalent sources); and
    e. Investment expenses at 0.15%.

[39] The impact of these changes was calculated at the Panel's request in the Applicant's response of September 25, 2020, decreasing the rate indications from an average of 13.5% to an average indicated increase of +9.4%.

[40] The Applicant is ordered to incorporate changes to the Rate Application as set out above and is **approved to adopt the proposed average rate change of 0.0%.**

[41] The approved rates will be effective on March 1, 2021 for new business and March 1, 2021 for renewal business.

Dated at Saint John, New Brunswick, on October 27, 2020.

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Marie-Claude Doucet, Panel Chair
New Brunswick Insurance Board

WE CONCUR:

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Ms. Francine Kanhai, Board Member

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Ms. Elizabeth Turgeon, Board Member