New Brunswick Insurance Board

DECISION

IN THE MATTER OF:

a rate revision application for the Definity Insurance Company

With respect to automobile insurance rates for

Private Passenger Vehicles

Hearing Dates: March 1-2, 2023

PANEL:	Chair	Ms. Marie-Claude Doucet, LL.B.
	Member	Ms. Francine Kanhai
	Member	Mr. Georges Leger
Applicant:	**Definity Insurance Company**	Ms. Nadia M. McPhee, LL.B.
Intervenors:	The Office of the Attorney General	Mr. Christopher Whibbs, LL.B. Mr. Jason Caissie, LL.B.
	The Office of the Consumer Advocate for Insurance	Ms. Michèle Pelletier K.C., LL.B.
Decision Rendered:	April 26, 2023	

Summary

[1] Definity Insurance Company (the "Applicant" or "Definity"), formerly known as Economical Mutual Insurance Company (“Economical”), filed a Rate Revision Application (the “Filing” or the “Application”) with respect to automobile insurance rates for Private Passenger Vehicles (“PPV”) in New Brunswick. Definity is requesting approval for a proposed overall average rate change of +17.0% before capping (+16.4% after capping) based on an indicated overall average rate change of +17.2%.

[2] Upon review of the Filing, the New Brunswick Insurance Board (the “Board”) determined that a hearing was required as the proposed overall average rate change exceeded the +3.00% legislative threshold. The Board therefore issued a Notice of Hearing on December 2, 2022. Pursuant to subsection 267.51(1) of the *Insurance Act*, R.S.N.B., 1973 c. I-12 (the “*Act*”), the Board convened a Panel of the Board (the “Panel”) to conduct an oral hearing (the “Hearing”) on March 1-2, 2023, in Saint John, New Brunswick.

[3] 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”). Both the OAG and the CAI intervened in this Hearing.

[4] The OAG intervened, questioned the Applicant by way of written interrogatories, submitted an expert report and a final written submission with the assistance of actuaries, Oliver Wyman (OW), and during the Hearing, called their own expert witness, presented oral submissions, and cross-examined the Applicant’s expert witness. The CAI intervened as well, filed a final written submission, presented an oral submission and cross-examined the Applicant’s expert witness during the Hearing.

[5] Following deliberations, on March 16, 2023, the Panel requested that the Applicant provide amended indications and impacts resulting from the following adjustments to the Filing:

1) For Accident Benefits,
    a. Maintain the frequency trend of 0.0% per annum; and
    b. Modify the severity trend to 0.0% per annum.

2) For Collision,

    a. Modify the frequency trend to 0.0% per annum; and

    b. Maintain the severity trend to 4.6 % per annum.

3) Modify the complement of credibility to use the net trend adjusted for the residual rate level change indication from the most recent filing in which the complement of credibility was the net trend (a.k.a. prospective loss ratio trend). More specifically, determine the complement of credibility as follows:

    a. For each of the coverages that are not fully credible, determine the prior residual rate level change indication as the gap between the indicated rate level change as found in the 2020-296 Filing, and the rate level changes implemented through both the 2020-296 Filing and the 2021-313 Filing.

    b. Apply the net trends from the current filing (after incorporating the requested adjustments in items 1 and 2 above) to adjust the prior coverage level residual rate level change indications.

The Board also requested that Definity take into consideration the results from the revised indication that combines all items as well as revise the proposed rate changes before and after capping, by coverage as well as overall, with updated rationales for deviations from the revised indications, if any.

[6] The Applicant responded to the request on March 23, 2023, with the additional information and supporting exhibits. The required changes, combined, result in a decrease to the Applicant's overall rate change indication from +17.2% to +6.9%. As part of the response provided on March 23, 2023, the Applicant requested to modify the effective dates of the rate change proposal to allow sufficient time for implementation. Combining the effect of the adjustments requested by the Board and the modified proposed effective dates, the revised overall rate change indication is +7.2% (before and after capping).

[7] The Panel, after examining all the evidence and submissions made by the parties, including the Applicant's response on March 23, 2023, determines that the indications in the Filing supporting the proposed overall average rate change must be modified. The Applicant is ordered to incorporate changes to the Filing as per the request for adjustments sent to the Applicant on March 17, 2023, and the Applicant's March 23, 2023 response.

[8] With the requested changes, the Panel finds that Definity's <u>revised</u> overall average rate level change of +7.2% is just and reasonable in these circumstances and Definity is ordered to adopt this amended overall average rate change.

[9] The approved rates will be effective on June 6, 2023 for new business and August 10, 2023 for renewal business.

Exhibits

[10] As part of the Hearing process, the Panel accepted the following Exhibits as part of the Record of Hearing:

EXHIBIT	DESCRIPTION	DATE
1a	Original Private Passenger Rate Filing part 1	August 30, 2022
1b	Original Private Passenger Rate Filing part 2	August 30, 2022
1c	Original Private Passenger Rate Filing part 3	August 30, 2022
2	Round 1 Questions from NBIB	September 27, 2022
3	Round 1 Response to NBIB	October 3, 2022
4	Round 2 Questions from NBIB	October 12, 2022
5	Round 2 Response to NBIB	October 14, 2022
6	Round 1 Questions from KPMG	October 21, 2022
7	Round 1 Response to KPMG	October 31, 2022
8	Round 2 Questions from KPMG	November 9, 2022
9	Round 2 Response to KPMG	November 16, 2022
10	Round 3 Questions from KPMG	November 16, 2022
11	Round 3 Response to KPMG	November 21, 2022
12	Actuarial Report KPMG	November 29, 2022
13	Round 1 Interrogatories (IRs) from OAG	January 6, 2023
14	Round 1 IRs Response from Applicant	January 13, 2023
15	Round 1 IRs Updated Response Q6 from Applicant	January 18, 2023
16	Round 2 IRs from OAG	January 20, 2023
17	Round 2 IRs Response from Applicant	January 27, 2023
18	Intervenor Report from OAG	February 10, 2023
19	Final Written Submission OAG	February 17, 2023
20	Final Written Submission CAI	February 17, 2023
21	Final Written Submission Definity	February 17, 2023
22	Correction to OAG Final Written Submission	February 21, 2023
23	NBIB Request for Revised Assumptions	March 17, 2023
24	Response to NBIB Request for Revised Assumptions	March 23, 2023

1. Introduction

[11] The Board is mandated by the Legislature with the general supervision of automobile insurance rates in the Province of New Brunswick. 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. The Board requires it to do so.

Procedural History

[12] The Applicant filed this Application for the PPV category on August 30, 2022. The original overall rate level change indication in the Filing was +17.2% and the Applicant sought an overall average rate increase of +17.0% before capping (+16.4% after capping).

[13] Following rounds of questions from the Board staff and consulting actuaries, KPMG, the Board issued a Notice of Hearing on December 2, 2022 and convened a Panel of the Board to conduct an Oral Hearing to consider the Application.

[14] Prior to the Hearing, the OAG submitted two sets of interrogatories to the Applicant. The Applicant responded to all questions posed and the answers form part of the Record before this Panel.

[15] Pre-hearing written submissions were provided by the Applicant, the OAG, and the CAI to the Panel for consideration.

[16] The Panel allowed the direct and cross-examination of actuarial expert witnesses by the parties during the Hearing held on March 1-2, 2023. The Panel also heard closing submissions from the Applicant, the OAG and the CAI following the *viva voce* evidence.

[17] On March 17, 2023, a request for revised indications based on alternative methods and assumptions was delivered to the Applicant by the Board, to which a response was received on March 23, 2023. The Applicant’s response was placed before the Panel and this decision was finalized thereafter.

2. Evidence and Positions of the Parties

Definity Insurance Company

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

[19] The following table summarizes the indicated and the proposed changes by coverage to the existing rates by coverage as of the date of the Hearing:

Coverage	**Indicated**	**Proposed (before capping)**	**Proposed (after capping)**
Bodily Injury (TPL-BI)	36.4%	32.0%	30.9%
Property Damage (TPL-PD)	Included w/BI		
Property Damage – Direct Compensation (DCPD)	-11.1%	-9.9%	-10.3%
Accident Benefits (AB)	57.2%	50.0%	48.7%
Uninsured Auto (UA)	10.2%	1.0%	0.9%
Collision (COL)	13.5%	13.1%	12.7%
Comprehensive (COM)	14.6%	14.1%	13.8%
Specified Perils (SP)	-1.0%	14.1%	12.6%
Underinsured Motorist (UM) – SEF44	-75.0%	0.0%	-0.5%
Total	17.2%	17.0%	16.4%

[20] In its Final Written Submission made to the Board, and in oral argument, the Applicant provided its rationale for its proposed rate increase, arguing that deteriorating trends and a rate deficit carried over from prior filings has led to rate inadequacy that is not sustainable.

[21] The Applicant argued that the data, assumptions, and methods underlying the Filing are reasonable and consistent, the data is reliable and sufficient, assumptions are appropriate and that the methods used are also appropriate. The Applicant argued that the alternative assumptions proposed by the OAG might individually be reasonable on an isolated basis but taken together result in an overly optimistic or unrealistic view of the true indication. Definity also cites the impact of inflationary pressures and the increasing frequency of theft because of the increasing value of used vehicles to support its proposed rates.

Office of the Attorney General

[22] The OAG intervened in the Hearing and took an active part in the review of the Application, questioning the assumptions therein through the interrogatory process, filing an expert report and making a written submission to the Panel. The OAG also participated actively in the oral hearing, questioning the Applicant's expert and calling its own expert witness from the firm of Oliver Wyman.

[23] The OAG argued that alternative assumptions, judgments and methods presented by its expert actuaries are more appropriate than those presented by the Applicant and would decrease the average overall indicated rate level change to +1.0%.

Office of the Consumer Advocate for Insurance

[24] The CAI participated in the Hearing and questioned the Applicant's expert witness. In her final written submission, she argued that the rate increase proposed by the Applicant is neither just nor reasonable. In particular, the CAI raised concern about the use of credit score as a rating factor for determining premiums, disproportionately affecting those who can least afford insurance.

[25] Other concerns raised by the CAI included the impact of COVID-19 on trends and patterns, and the proposed 12% target return on equity. It was the position of the CAI that the alternatives presented by the OAG are more appropriate and that these alternatives ought to be preferred and applied in favour of New Brunswick policyholders.

3. Analysis and Reasons

[26] The Panel has reviewed all the written evidence in the Record including the Filing, the responses to the interrogatories, the final submissions from all parties and the alternative rate change indications provided by the Applicant on March 23, 2023. The Panel also heard and considered all the *viva voce* evidence provided at the Hearing, along with the oral submissions from counsel.

[27] The Panel recognizes and accepts the actuarial expertise of both the Applicant's actuaries who prepared the Filing and responded to the various inquiries and the expert actuaries, OW, acting on behalf of the OAG.

[28] The Panel's decision accounts for the complexity and interactions between data assumptions, judgement, models and methods. As set out below in more detail, the Panel did not fully accept the Applicant's evidence as satisfying its evidentiary burden of establishing that the proposed rates were just and reasonable. The Panel concludes that the Applicant must modify some of the assumptions and methods used in its indications in accordance with its response dated March 23, 2023 and approves the resultant overall average rate change of +7.2%.

[29] That evidence identified several aspects of the Filing where alternative methods and / or assumptions were argued to be more appropriate. Areas of concerns that were addressed at the Hearing, and which will be considered in this decision, included:

A. Estimates of Ultimate Loss Amounts
B. Loss Trend
    a. DCPD – Frequency and Severity
    b. Collision - Severity
    c. Accident Benefits – Severity
C. Return on Investment

D. Complement of Credibility

E. Expense Provision

F. Credit Score

G. COVID-19

H. Profit Provision

A. Estimates of Ultimate Loss Amounts

[30] In its Filing, the Applicant detailed a four-step process for adjustments that form part of its estimation of selected ultimate loss amounts. At the Hearing, the Applicant's evidence on the issue focused more on the need for adjustments which became necessary as a result of changing claims patterns due to COVID-19 impacts. The Applicant's actuarial expert witness testified that losses developed more slowly than expected due to the effect of the pandemic. These estimates are provided by the Applicant's Appointed Actuary ("AA"), and questions were raised during cross examination concerning whether the Pricing Actuary ("PA") was taking 'responsibility' for those calculations for the purpose of the Filing. The evidence was clear, however, that the PA was responsible for the decision that the estimates, as calculated by the AA, were appropriate for the ratemaking purpose of this Filing. The estimates were reviewed for reasonableness and based on the evidence, the Panel finds that it is not inappropriate for the Applicant's PA to rely on, and adopt, another internal actuary colleague's work where it is reasonable to do so. The AA's estimates that were used in this Filing did not incorporate any discounting or margins that might be inappropriate for pricing purposes. The Panel accepts this approach as a reasonable one for this Filing.

B. Loss Trends

[31] Loss cost trends are assumptions that measure the annual rates of change in claim costs from historical periods to projection period.

[32] The selection of loss cost trends should reasonably reflect the rates of change in the historical experience and represent sensible estimates of future expected rates of change for each coverage. To

achieve that objective, the selection of loss cost trends requires the analysis of historical data and anticipated conditions, as well as the application of professional judgment.

a. DCPD – Frequency and Severity

[33] To select loss cost trends for the DCPD coverage, the Applicant separately modelled the frequency (using data from 2017H1 through 2019H2) and severity (using data from 2015H1 through 2021H2).

[34] The Applicant's frequency trend modelling had a very low adjusted R-squared and a high p-value indicating that the hypothesis of a 0% frequency trend cannot be rejected. As a result, the Applicant selected a 0% frequency trend. The OAG argued that the Applicant's fitted frequency trend of -0.6% would be more appropriate based on visual inspection. The Panel agrees with the Applicant that there is no discernable frequency trend and accepts that the 0% assumption is appropriate.

[35] For severity, the Applicant selected a trend of +4.1% based on a model with an adjusted R-squared value of 65.47% and p-value of 0%.

[36] OW, on behalf of OAG, argued that it would have been more appropriate for Definity to include a longer historical period in the severity trend analysis. OW suggested that an alternative model using data from 2014H1 through 2021H2 would result in a slightly flatter severity trend of +3.3%. The OW model resulted in statistical measures that are relatively equivalent to those of the Applicant's model. The Applicant did not include data from 2014 and prior in its trend analyses for short tail coverages like DCPD because of a transfer of business in 2015 that significantly increased its book of business and altered the mix of business. As a result, it argued that the 2014 and prior data was not sufficiently representative of the more recent and current mix of business and would therefore be inappropriate data to consider for the purpose of trend analyses.

[37] The additional data points, which OW suggests should be included, fall within that time period with the prior book of business. Apart from that argument, it is also recognized by the Panel that DCPD is a short tail coverage, and that older data is therefore less reflective or impactful on future trends. The use of a shorter experience period for the trend analysis is considered appropriate for this coverage, and the

Applicant has been consistent with that approach for all of the short tail coverages. In these circumstances, the Panel accepts the Applicant's DCPD trend models and assumptions.

b. Collision - Severity

[38] Closely aligned with the loss cost trend analysis for the DCPD coverage is the analysis for the Collision coverage. As with DCPD, the Applicant modelled frequency and severity trends separately, then combined the results to determine the loss cost trend.

[39] The selected frequency trend of +0.7%, with which OW has no disagreement, was modelled by the Applicant using data from 2015H1 through 2019H2. The low adjusted R-squared and high p-value indicate that the hypothesis of a 0% frequency trend cannot be rejected. For sensitivity testing purpose, the Board's consulting actuaries requested an alternative rate change indication using a frequency trend of 0%. The Applicant indicated that the overall rate change indication would decrease by 0.5% point. The Applicant considered that its selected +0.7% trend could be supported based on visual inspection of the frequency graph. The Applicant also acknowledges that a 0% frequency trend could be a sensible alternative within the range of reasonable assumptions. The Panel notes that the Applicant selected a frequency trend of 0% for the DCPD coverage, which features similar goodness-of-fit statistics and visual aspects as the Collision model. Given that DCPD and Collision frequencies are highly correlated, it is understood that their trends would be expected to be reasonably aligned, but not necessarily identical. Considering the poor statistical measures and the discrepancies in trend selection approach between DCPD and Collision, the Panel finds that the Applicant's evidence to support the reasonableness of its proposed frequency trend of +0.7% for Collision is not satisfactory. The Applicant is therefore required to adopt a 0% frequency trend for Collision coverage. This is included in the amended indications provided by the Applicant on March 23, 2023.

[40] The Applicant selected a Collision severity trend of +4.6%, based on a model using data from 2017H1 through 2021H2. The model presented by the Applicant resulted in an R-squared value of 50.36% and a p-value of 3.7%. The Applicant observes no shift in the data and incorporates no scalar in its modelling.

[41] In contrast, OW adopts a longer historical period to model the Collision severity: from 2010H1 through 2019H2. According to OW, the data indicates a 'level change' between 2018H1 and 2018H2, and based on this observation, OW inserted a scalar parameter at that point. Thereafter, OW suggested that there is a 0% trend in the severity data. OW's high adjusted R-squared of 83.8% would normally indicate a good fit when no other factors are considered. Its high p-value of 45.7% confirms that the 0% trend could not be rejected.

[42] Arguably the statistical measures of the Applicant's model would indicate a poorer fit than that obtained from OW's model. The Panel notes that given that DCPD and Collision severities are highly correlated, it is understood that their trends would be expected to be reasonably aligned, but not necessarily identical. The Applicant effectively selected a Collision severity trend that is in the same direction and of similar magnitude as the DCPD severity trend. While OW's model results in a good statistical fit, it is vulnerable to over-fitting. Apart from the evidence based on a visual inspection, OW did not provide additional reasons justifying the insertion of a scalar in 2018.

[43] In the absence of a rationale for this alleged sudden shift in the severity data, the Panel finds the scalar model from OW to be non-persuasive. The Applicant's modelling is realistic, consistent and reasonable, and the suggested severity trend of +4.6% is accepted.

c. Accident Benefits - Severity

[44] For the Accident Benefits coverage loss cost trends, the Applicant modelled both frequency and severity separately, as it had done for other coverages. Unlike the previously discussed coverages, however, Accident Benefits is a long-tail coverage, often taking longer to resolve following the claim reporting. This typically requires analysis based on a longer historical period.

[45] The Applicant's selected frequency trend of 0% was modelled using data from 2015H1 through 2019H2, and that frequency trend was accepted by the OAG and this Panel as being reasonable.

[46] For severity, Definity used a credibility weighted average of its own data for two different periods (2014H1 through 2021H2 and 2017H1 through 2021H2) as well as two different periods of industry

data (2016H1 through 2020H2 and 2017H1 through 2020H2). The industry data was included to counter the insufficient credibility of the Applicant's own internal data. The resultant selected severity trend for this coverage is +2.4%, both past and future.

[47] Definity bases its trend analyses on historical periods that follow the 2013 reform to the Minor Injury Regulation (MIR) to minimize the impact on trend analysis. The data is sparse and volatile, which has a negative impact on the goodness of fit of the various models.

[48] The OAG did not present an alternative model but argued that a trend of 0% is more reasonable than the Applicant's selection, with its poor statistical measures. Further, the OAG rationalizes that the 2013 reform to the MIR introduced uncertainty for Accident Benefits that resulted in a phase-in of higher costs over time, which it argues has intermingled with the pure loss trend. As a result, it is argued, an application of the trend between 2014 and 2018 into the future would likely overstate future severity trend rate. Evidence of this, argues the OAG, is found in the higher trend rates observed in those periods closer to the reform date. The Panel is not persuaded by this particular argument from the OAG, as the Accident Benefits coverage is not materially impacted by the MIR in New Brunswick.

[49] Considering the poor statistical measures of the Applicant's model, the Board's consulting actuaries, KPMG, requested the Applicant to provide sensitivity testing using a severity trend of 0.0%. Overall indications would decrease by -0.8% point with that revision only.

[50] The Applicant argues that an ill-fitting model is not necessarily less reasonable than a 0% severity trend. Considering the currently inflationary environment, Definity anticipates a small increase in severity in line with the trend it selected.

[51] The Panel is mindful of the poor statistical measures of the model relied upon by the Applicant to support its selected Accident Benefits severity trend. The current inflationary environment cannot support the selection of a positive trend for the historical period (i.e., past trend). While the Applicant raises the inflationary environment as an argument in favour of a positive future severity trend for the Accident Benefits coverage, they have not provided sufficient support for this position as in pertains to this specific coverage and for the appropriate quantum of the future severity trend on Accident

Benefits. A trend of 0% can therefore not reasonably be rejected and the Panel requires that the revision be made, as included in the amendments provided on March 23, 2023.

C. RETURN ON INVESTMENT

[52] The Applicant selected return on investment rates of 2.8% for policyholder funds (pre-tax), and 1.99% (post-tax) for investment returns on equity.

[53] For the 2.8% assumption, Definity considered expected yield from its own investment portfolio as of March 2022, which is consistent with its approach to value its claim liabilities. The Applicant has partially recognized recent interest movements by increasing the selected return on investment by 13 base points.

[54] Based on the average of actual historical investment returns for 2019 through 2021, the OAG argued that the Applicant's selections are understating the expected investment income, thereby overstating the indicated rate change.

[55] The Panel recognizes the value of the average or historical rates of return from 2019 through 2021 as a diagnostic flag but confirms that ratemaking is a prospective exercise. The rates of return in the P&C-1 return reflect past capital gains or losses that may not be recurrent. They do not reflect expected future yields from the Applicant's investment portfolio supporting the insurance cashflows. They do not reflect the expected investment yield from new money when necessary.

[56] It is understood that the current inflation environment has put some upward pressure on the interest rates. It is also understood that the current inflation considerations should be taken into account in a coherent manner across assumptions such as prospective return on investment and future loss cost trends. The Panel is of the view that the Applicant has treated the inflation in a consistent manner in this Filing. The Panel finds that Definity's assumptions for return on investment are appropriate, reasonable and compliant with the Standards of Practice of the Canadian Institute of Actuaries (CIA).

D. COMPLEMENT OF CREDIBILITY

[57] Insofar as an insurer's own New Brunswick data is not considered to be sufficiently credible, it is standard actuarial practice to complement this internal data with another data source. This is primarily the case for the TPL-BI and AB coverages where claim counts are low and claim amounts are volatile. Definity's own experience achieves full credibility for DCPD, Collision and Comprehensive coverages.

[58] As a complement of credibility, Definity used the industry loss data adjusted only to align the territorial distribution with Definity's book of business. Definity did not adjust the industry data for other classification dimensions. In the Applicant's view, this approach satisfies the criteria for a good complement of credibility, namely: being unbiased, accurate, statistically independent from the base statistic, available, easy to compute and with a logical relationship to the base statistic. This method is in line with the previous filing.

[59] The OAG argued that Definity's adjustments to the industry data were incomplete and did not sufficiently align the complement of credibility with the Applicant's profile. The OAG further argued that the differences between the adjusted industry loss costs and the insurer's experience are sufficiently large that the probability for the two sets of loss costs to represent the same population is remote.

[60] Definity commented on the reasons why it did not adjust the industry data to reflect Definity's mix of business for classification dimensions other than the territorial distribution. The Applicant indicated its concerns regarding the potential insertion of bias due to the magnitude of excluded records from the available industry data in some classification exhibits. It also raised its concerns about the difficulty to appropriately reflect the correlation between the experience presented in the industry territorial exhibit and the urban/rural dimension in the class and driving record exhibit. Finally, the Applicant indicated that the variances between the adjusted industry loss costs and its own experience are justified given that it observes significant differences between competitors' quotes, and it aims at aligning its mix of business with the industry distribution through planned growth.

[61] The OAG suggested that the 'net trend method' is a more reasonable approach, highlighting that the Applicant's selected complement of credibility increases the indication by 8.5%; nearly half of the indicated increase.

[62] Net trend as complement of credibility considers the loss cost trend and the premium trend offset. This assumes that the currently approved rate levels are adequate, notwithstanding the additional rate change that would be necessary to cover the net trend.

[63] As a variant of the preceding complement of credibility, the net trend plus gap combines loss cost trend, premium trend and the residual rate level change from the previous filing (determined as the gap between the approved and the indicated rate level changes from the previous filing). This assumes that the emerging facts and circumstances did not alter the reasonableness of the previous rate level indication, notwithstanding the additional rate change that would be needed to cover the net trend.

[64] Definity demonstrated that the currently approved rate levels are inadequate, which invalidates the use of the standalone net trend as a complement of credibility. It also responded that the reliance on previous experience does not fulfil the independence criterion, and perpetuates volatility, noise and potential error present in the small sample. Thus, the Applicant maintains that the use of net trend plus gap as a complement of credibility is inappropriate.

[65] The Panel noted that these alternative approaches to select a complement of credibility have a material impact on the indicated rate level changes. The Panel recognizes the difficulty to balance all the criteria of a good complement of credibility. While it understands that the use of adjusted industry data is a generally accepted actuarial approach, it deemed that the Applicant did not meet its evidentiary burden of establishing the appropriateness of the selected complement of credibility in these circumstances. The Panel concluded that the territorial adjustments applied to the industry data were insufficient to reasonably align this data with the Applicant's profile. While balancing the countervailing criteria of a good complement of credibility, the Panel considered that the net trend plus gap approach would be the most reasonable approach for this Filing. However, this approach could not be based on last year's filing (the "2021 Filing"), as it also relied on the adjusted industry data as a complement of credibility and the individual assumptions underlying the 2021 Filing had not been fully assessed and

considered at a Hearing. As such, the previously indicated rate level changes, which are required to determine the residual rate level change, had not received the degree of scrutiny appropriate for the current purpose. The most recent hearing conducted for the Applicant, then known as Economical, was based on the 2020 Filing. As such, the Panel finds that the most reasonable and accurate method to determine the complement credibility for the current Filing is to use the alternative complement of credibility assumption requested by the Board on March 16, 2023:

> Modify the complement of credibility to use the net trend adjusted for the residual rate level change indication from the most recent filing in which the complement of credibility was the net trend (a.k.a. prospective loss ratio trend). More specifically, determine the complement of credibility as follows:
>
> a. For each of the coverages that are not fully credible, determine the prior residual rate level change indication as the gap between the indicated rate level change as found in the 2020-296 Filing, and the rate level changes implemented through both the 2020-296 Filing and the 2021-313 Filing.
>
>   In accordance with our records, the following table summarizes the indicated rate level changes and the Board approved rate level changes for the relevant coverages.

Coverage	Indicated Rate Level Change 2020-296	Uncapped Approved Rate Level Change 2020-296	Uncapped Approved Rate Level Change 2021-313
Third Party Liability - BI	5.34%	2.61%	1.10%
Third Party Liability - PD	Included with BI		
Accident Benefits	14.15%	2.63%	1.50%
Uninsured Automobile	-2.75%	-0.02%	-0.03%
Underinsured Motorist	-1.84%	0.00%	0.00%
Specified Perils	1.00%	2.74%	7.00%

b. Apply the net trends from the current filing (after incorporating the requested adjustments in items 1 and 2 above) to adjust the prior coverage level residual rate level change indications.

[66] The Panel requires that the changes be made to the Filing, as set out in the Applicant's response of March 23, 2023.

D. EXPENSES

[67] In selecting the assumptions for prospective expenses, Definity includes regular commissions, premium tax, health levy and profit and bonus commissions as variable expenses. Fixed expenses include branch, head office, regional and unallocated loss adjustment expenses. This approach from the Applicant with respect to expenses has remained unchanged over prior filings. Software implementation costs and amortization are excluded. Definity submits that its selected expenses are forward-looking and in line with the current expense environment.

[68] The OAG's position, following analysis by OW, is that the Applicant's assumptions for profit commission and regional claim costs are too high and not consistent with the historical observed rates.

[69] Definity's selected profit commission is 1.9 % for the upcoming period, while the historical rate for the last four years ranged from 0.8% to 1.8%. The OAG argued that profits in 2023/2024 will be less than those experienced during the COVID-19 pandemic as claims move toward normal levels. The OAG suggested that a profit commission of 1% would be more reasonable as it would fall within historical range.

[70] With respect to regional claim costs, Definity's selected rate is 4.0% while the historical rates for 2019 through 2022 range from 2.9% to 4.6%. The OAG suggested that selecting a regional claim cost rate of 3.2% based on the 2019-2021 average would be a more reasonable assumption.

[71] Definity responded that expenses should be viewed as a whole: increases in some expense headers are offset by decreases in other areas. The variable expenses, viewed as a whole, between 2019 and 2022 average at 18.28%; the Applicant has selected 18.3%. Similarly, the 2019-2022 average of fixed expenses amounts to 7.3% while the Applicant selected 7.1%.

[72] The Panel understands the value of monitoring the expenses by category as operational diagnostics. It also recognizes that reallocations of expenses can occur. The Panel deems that it is more reasonable to view the variable and fixed expenses as a whole in these circumstances. The Panel finds the Applicant's selections to be reasonable.

F. CREDIT SCORE

[73] Definity seeks to adopt a policyholder's credit score as a rating factor for determining premiums. The CAI raised concern with this approach, arguing that it might negatively impact those who can least afford insurance. She points out that it is not a permissible factor in Newfoundland and Labrador or Ontario.

[74] Definity does not have experience data for this Province as it had not collected credit score information for its PPV business in New Brunswick. It proposes to offer discounts based on PPV indicated loss cost relativities in the Province of Quebec where credit score has been used for rating purposes for many years. While it proposes to implement discounts that are moderate and conservative, it aims at achieving two goals: a) recognizing the reduction in loss costs with improved credit score and b)

avoiding double counting the impact from other correlated factors already present in the rating algorithm. As experience data is collected in New Brunswick, the Applicant is committed to reassessing the reasonableness of the proposed credit score differentials in future filings. The proposed credit score discount ranges between 0% and 20%. Using the distribution of credit scores in Nova Scotia to estimate the average discount, Definity balances back the premium rates to achieve the target increase.

[75] The Panel accepts, as it has been the case in several past decisions of panels, that credit score related discounts may be reasonable as there is a reasonable correlation with risk. The Board maintains a watchful eye on this rating factor, subject to any guidance that may come from the Superintendent of Insurance.

G. COVID-19

[76] As noted previously, ratemaking is a prospective exercise. In other words, the rates charged must be just and reasonable for the prospective period in which the rates will be in effect. They should not be excessive, nor should they be inadequate. Rates should reflect the best estimate of future costs associated with the insurance contract. The COVID-19 pandemic that hit New Brunswick in 2020, and continues to a lesser extent today, changed the loss experience for all insurance companies in the province. The responsibility for the insurer, and this Panel, is to ensure that the upcoming policies will appropriately consider the future environment, including consideration of the impact of COVID-19.

[77] Definity confirms that all COVID-19 relief measures that may have been in place during the height of the pandemic have been discontinued. The impact of COVID-19 on losses and claims has been incorporated into the Filing analysis through adjustments to the data when loss trends were being determined. Often, pandemic related data points were excluded. The Filing assumes that frequency of claims will revert to pre-Covid levels for the upcoming period.

[78] Overall, the Panel is satisfied that the Applicant has appropriately considered the impact of COVID-19 for the upcoming policy period.

H. Profit Provision

[79] Definity adopted a 12% after-tax target Return on Equity ("ROE") for the purpose of its Filing and its proposed overall average rate change results in an Implied ROE of 12.21%. While the OAG raised no concern with the assumption, the CAI argued that these assumptions lead to excessive and unreasonable rate indications which would not be permitted in some of New Brunswick's neighbouring provinces and Ontario.

[80] The Panel was not presented with evidence, beyond argument and identification of different treatment in different jurisdictions, which 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 jurisdictions, this Panel is satisfied that a target after-tax target ROE of 12% is reasonable in the circumstances.

[81] The Panel reiterates that there is no benchmark for the target ROE in New Brunswick, and each application is assessed individually on a case-by-case basis after considering the relevant circumstances.

4. Decision

[82] For the reasons set out above, the Panel finds that the Applicant's Filing is not just and reasonable in its entirety and the Applicant is ordered to amend its Filing and to include the amended indications and impacts resulting from the March 23, 2023 response from Definity, adopting the following adjustments to assumptions:

For Accident Benefits,

a) Maintain the frequency trend of 0.0% per annum; and
b) Modify the severity trend to 0.0% per annum.

For Collision,

a) Modify the frequency trend to 0.0% per annum; and
b) Maintain the severity trend to 4.6 % per annum.

Modify the complement of credibility to use the net trend adjusted for the residual rate level change indication from the most recent filing in which the complement of credibility was the net trend (a.k.a. prospective loss ratio trend). More specifically, determine the complement of credibility as follows:

a) For each of the coverages that are not fully credible, determine the prior residual rate level change indication as the gap between the indicated rate level change as found in the 2020-296 Filing, and the rate level changes implemented through both the 2020-296 Filing and the 2021-313 Filing.

b) Apply the net trends from the current filing (after incorporating the requested adjustments in items 1 and 2 above) to adjust the prior coverage level residual rate level change indications.

[83] The Applicant is **approved to adopt the overall average rate increase of +7.2%.**

[84] The approved rates will be effective on June 6, 2023, for new business and August 10 2023, for renewal business.

Dated at Saint John, New Brunswick, on April 26, 2023.

Ms. Marie-Claude Doucet, Chair

New Brunswick Insurance Board

WE CONCUR:

Ms. Francine Kanhai, Board Member

Mr. Georges Leger, Board Member