Corrected Decision : A corrigendum was issued on May 25, 2022; the corrections have been made to the text and the corrigendum is appended to this Decision.

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 Dates: March 8 and 16, 2022
Written Hearing

PANEL:	Mr. Marven Grant	Vice-Chair
	Ms. Rachel Arseneau-Ferguson	Member
	Ms. Elizabeth Turgeon, LL.B.	Member

Applicant: **Sonnet Insurance Company**

Intervenors: **The Office of the Attorney General**
The Office of the Consumer Advocate for Insurance

Decision Rendered April 08, 2022

Summary

[1] Sonnet Insurance Company (the "Applicant" or "Sonnet") filed an application to revise rates (the “Filing” or the “Application”) with respect to automobile insurance rates for Private Passenger Vehicles (“PPV”) in New Brunswick. Sonnet presented its Filing to the Board based on an overall rate change indication of +11.30% and proposed an overall average rate increase of +8.24% (7.92% after capping). The Applicant thereafter made minor amendments to the Filing, changing the indication to +11.70% but maintained its proposed average rate change of +8.24%, with a slightly changed proposed rate change of +7.90%, after capping.

[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”) convened a Panel of the Board (the “Panel”) to conduct a Written Hearing (the “Hearing”) on March 8, 2022 with deliberations held by video conference. The Panel reconvened on March 16, 2022 to conclude its deliberations by video conference.

[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; the OAG submitted an expert report and a final written submission with the assistance of actuaries, Oliver Wyman (OW), while the CAI filed a written submission and adopted the position of the OAG.

[4] Following initial deliberations on March 8, 2022, the Panel requested that the Applicant provide the following additional information:

I) Table that shows the gross written premium, gross earned premium, variable expenses, direct expenses, HO expenses, regional claims costs and ILAE as forecasted for 2022, 2023 and 2024.

II) Table that shows the direct expenses broken down between marketing costs, staff costs and other (corporate, credit, travel, etc.) as forecasted for 2022, 2023 and 2024.

[5] Furthermore, using the amended filing dated December 9, 2021, as the baseline, the Panel requested Sonnet provide the Board with alternative indications as to the impact of the following adjustments to its expense assumptions:

a. Modify the Head Office expenses to exclude the $244,000 of Guidewire costs related to the platform amortization.
b. Modify the direct expense ratio to use in turn
c. the forecast 2022;
d. the forecast 2023; and
e. the forecast 2024.

[6] Specifically, the Panel requested that Sonnet provide revised indications (including details of the impact by coverage, as well as on an overall basis):

1) The impact from the baseline for each item 1, 2a, 2b, and 2c alone;
2) The impact from the baseline for the combination of items 1 and 2a;
3) The impact from the baseline for the combination of items 1 and 2b; and
4) The impact from the baseline for the combination of items 1 and 2c.

[7] The requested information was provided by the Applicant on March 11, 2022, and the Panel reconvened on March 16, 2022, to conclude its deliberations.

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

[9] The Applicant is ordered to incorporate changes to the Filing as follows:

a. Modify the expense assumptions to exclude the Guidewire costs related to the platform amortization from Head Office Expenses; and,
b. Modify its direct expense ratio to use 15.0% instead of 16.8%.

[10] The required changes as set out in paragraph [7] result in a decrease to Sonnet's overall indication for a rate increase from 11.7% to 8.5%.

[11] The Panel finds that Sonnet's proposed average rate change is just and reasonable in the circumstances and Sonnet is **approved to adopt the proposed average rate change of +8.24%, +7.9% after capping.**

[12] The approved rates will be implemented by the Applicant in two phases due to system constraints.

[13] In Phase 1, Sonnet will implement the approved overall rate change and proposed changes to segmentation related to existing rating variables. Phase 1 will be effective for April 16, 2022 for new business and May 31, 2022 for renewal business.

[14] In Phase 2, Sonnet will implement the remaining segmentation changes (i.e., introduction of two new rating variables) approved by the Board as part of this Filing. Phase 2 will be effective August 1, 2022 for new business and September 15, 2022 for renewals.

Exhibits

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

EXHIBIT	DESCRIPTION	DATE
1	Original Private Passenger Vehicles Rate Filing	July 26, 2021
2	Amendment to Filing	July 31, 2021
3	Round 1 Questions from KPMG	August 24, 2021
4	Round 1 Questions from NBIB	August 25, 2021
5	Round 1 Response to NBIB	August 29, 2021
6	Round 1 Response to KPMG	August 29, 2021
7	Round 2 Questions from KPMG	September 10, 2021
8	Round 2 Response to KPMG	September 15, 2021
9	Round 3 Questions from KPMG	September 24, 2021
10	Round 3 Response to KPMG	September 30, 2021
11	Staggered Effective Dates Request	September 30, 2021
12	KPMG Storyboard	October 8, 2021
13	Withdrawal of Staggered Effective Dates	October 14, 2021
14	Amendment to Filing	December 9, 2021
15	Round 1 Interrogatories - OAG to Applicant	December 10, 2021
16	KPMG Amended Storyboard	December 15, 2021
17	Round 1 Interrogatories - Applicant Response to OAG	December 17, 2021
18	Round 2 Interrogatories - OAG to Applicant	January 7, 2022
19	Round 2 Interrogatories - Applicant Response to OAG	January 14, 2022
20	Intervenor Expert Report from OAG	January 28, 2022
21	CAI Final Written Submission	February 9, 2022
22	Sonnet Final Written Submission	February 11, 2022
23	OAG Final Written Submission	February 11, 2022
24	Board’s Request for Information	March 9, 2022
25	Sonnet’s Response to Board Request	March 11, 2022

1. Introduction

[16] 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

[17] The Applicant filed this Application for the PPV category on July 26, 2021. The original overall rate level change indication of the Filing was +11.30% and the Applicant sought an overall average rate increase of + 8.24% (+7.92% after capping).

[18] On December 9, 2021, as a result of changing the proposed effective dates and updating the data used in the off-balance calculations, the Applicant submitted an Amended Filing increasing its overall rate level change indication to +11.70% with the proposed overall average rate increase remaining essentially unchanged at+ 8.24% (+7.90% after capping).

[19] The Board issued a Notice of Hearing on October 28, 2021 and convened a Panel of the Board to conduct a Written Hearing on the matter. The OAG and the CAI both provided notice of their respective intentions to intervene in the Hearing.

[20] Prior to the Hearing, in addition to the Filing, additional information and clarification was generated: the Board posed a number of questions to the Applicant through four (4) rounds of questions from the

Board’s staff and its actuaries, and 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.

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

[22] The Hearing into this Application commenced on March 8, 2022.

[23] On March 9, 2022 an additional request for information was delivered to Sonnet, to which responses were received on March 11, 2022. That additional information was placed before the Panel when it reconvened on March 16, 2022 to complete the Written Hearing.

2. Evidence and Positions of the Parties

Sonnet Insurance Company

[24] Sonnet is the only fully online automobile insurance company operating in New Brunswick. It is part of the Economical Insurance group. At the time of the present Filing, Sonnet neared five years of operation in the New Brunswick market.

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

[26] Sonnet points to several emerging issues and trends that are creating upward pressures on insurance rates including: distracted driving, prevalence of sensors, labour costs, weather, supply chain disruptions and inflation.

[27] Sonnet initially presented its Filing to the Board with an overall original rate change indication of +11.3% and proposed an overall average rate increase of +8.24% (+7.92% after capping). The Applicant amended its rate application on December 9, 2021, resulting in an overall rate change indication of +11.7% and a proposed overall average rate change of +8.24% (+7.9% after capping).

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

Coverage	Indicated	Proposed (Before Capping)	Proposed (After Capping)
Bodily Injury (BI)	3.70%	2.20%	2.26%
Property Damage (PD)	Incl. with BI	Incl. with BI	Incl. with BI
Property Damage – Direct Compensation (DCPD)	1.00%	0.00%	-0.35%
Accident Benefits (AB)	0.00%	0.00%	-0.03%
Uninsured Auto (UA)	11.30%	-0.80%	0.03%
Collision	31.20%	20.00%	19.39%
Comprehensive	33.30%	20.00%	19.12%
Specified Perils (SP)	11.20%	20.00%	20.02%
Underinsured Motorist (UM) – SEF44	-57.22%	0.00%	-0.20%
Total	11.70%	8.24%	7.90%

[29] The rate indication calculations detailed in the Filing incorporate various assumptions, including a target return on equity (ROE) of 12% (implied ROE with proposed rate change of 9.53%), a pre-tax investment rate on cash flow (ROI) of 2.50%, an after-tax investment rate on capital of 1.78%, and a 2:1 premium to surplus ratio. Proposed average rates would increase from the current average premium of approximately $1,473 to approximately $1,594 (before capping) and $1,589 (after capping).

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

> Sonnet has not filed for a rate increase since 2019 (which came in effect in April 2020). In light of inflationary pressures, supply chain disruptions, and high repair costs of the current environment, the rate proposed for approval is reasonable, minimal, and necessary considering Sonnet has not adjusted rates for two years in a row.
>
> In this context, it is important that the Board approves Sonnet's application as proposed. Sonnet would like to mention that the overall proposed rate is set to 3.5% lower than the rate indication in an effort to provide as much rate stability to New Brunswick customers as possible while still addressing rate adequacy. In addition, with this filing, Sonnet proposes to introduce capping, […] to further strengthen premium stability.
>
> [Exhibit 22, page 896 of the Record]

[31] 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

[32] The OAG intervened in the Hearing and took an active part in the review of the Application, questioning the assumptions therein, filing an expert report and making a written submission to the Panel. That final written submission, prepared with the assistance of its expert actuaries, OW, identified several aspects of the Filing where alternative calculations and / or assumptions were argued to be more appropriate. Areas of concerns that were raised by the OAG to be addressed at the Hearing include:

A. Accident Year Weights
B. Estimated Loss Ratio at Current Rate Level
C. Expenses – Amortization of Guidewire System
D. Expenses – Excess Acquisition Expenses
E. Return on Equity (ROE) / Return on Premium (ROP)
F. Return on Investment Rate (ROI)
G. Credit Score
H. Covid-19

[33] The OAG argues that with alternative assumptions, judgments, and calculations, which it suggests are more appropriate, they find "the overall rate level change need to be less than the rate change proposed by Sonnet".

Consumer Advocate for Insurance

[34] The CAI, in her final written submission, argued that the "rates must be just and reasonable for the consumers of New Brunswick," that the alternatives presented by the Intervenors are more appropriate and that these alternatives ought to be preferred and applied in favour of New Brunswick consumers.

[35] The CAI points to an expected downward pressure on loss costs arising from the Covid-19 and the resultant decrease in traffic / accidents, as one of the considerations that this Panel should take into account. Further, the CAI questions the Applicant's direct expenses, introduction of credit score into the rating process and the Applicant's target ROE of 12%. In conclusion, she submits:

> **"**The CAI reiterates to the Board that automobile insurance is mandatory in New Brunswick and therefore, rates should be reasonable, affordable and fair. With huge increases requested by the present insurer, we submit the consumers of New Brunswick may have difficulties paying their insurance premiums. We ask the Board to choose the alternatives presented by the Office of the Attorney General, which are reasonable under all circumstances."
>
> [Exhibit 21, page 890 of the Record]

3. Analysis and Reasons

[36] The Panel has reviewed all the written evidence before it, including the interrogatories and written submissions from all parties and the additional information provided by the Applicant at the Panel's request.

[37] 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, on behalf of the OAG.

[38] 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.

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

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

A. Accident Year Weights

[41] The Applicant uses accident year weights to blend the experience data from the four (4) accident years in its rate indication to estimate the projected loss ratio for the prospective period. The adoption of a given weight for a particular historical accident year is a judgment made by Sonnet based on a number of factors, but the intention should be to ensure that the resulting projected loss ratio is as representative as possible of the expected conditions in the period in which the proposed rates will be effective.

[42] Sonnet recognizes that it is a relatively new company, and that it has been experiencing rapid growth. As such, its portfolio of 2017 is less representative of the more recent years or the anticipated future. Sonnet therefore proposes to assign weights of only 3% and 12% to the experience of accident years 2017 and 2018 respectively, leaving most of the weight to be assigned to the most recent accident years. Sonnet also acknowledges that because of the Covid-19 measures, the experience for accident year 2020 is not necessarily representative of the prospective period during which the proposed rates are expected to be in effect. With this factual matrix, Sonnet proposes to balance responsiveness and stability by assigning most, but not all, of the weight to the experience of the most recent accident years, while still assigning some weight to the experience of accident years 2017 and 2018.

[43] The OAG points out, and Sonnet concurs, that the observed experience for accident years 2019 and 2020 demonstrates considerable improvement over the experience of accident years 2017 and 2018. Sonnet's growth over the last four years has resulted in significant changes to its mix of business. The impact of the Covid-19 pandemic admittedly adds uncertainty to this already evolving business mix.

[44] The parties disagree, however, on how the experience of each of accident year should be treated for the purpose of this Filing. The OAG suggests that the rate indication should be based only on Sonnet's experience for accident years 2019 and 2020. The OAG recognizes however that the experience of accident year 2020 is immature. In addition to being highly dependent on very uncertain development factors, the uncertainty surrounding this ultimate experience for accident year 2020 is further increased as a result of the Covid-19 measures. In response to the OAG's questioning through interrogatories, Sonnet provided alternative indications, using only accident years 2019 and 2020 data, for sensitivity testing purpose. The indicated average rate increases for the alternative indications that placed some

weight on both of these accident years would be between +7.9% and +9.8%, compared to the Filing indication of +11.7%.

[45] The Panel recognizes that Sonnet's significant business growth combined with the continuing pandemic, has created a great deal of continuing uncertainty. The methodology it adopts in the Filing is a reasonable one, albeit imperfect. The Panel accepts that the 2017 data is not particularly reflective of the anticipated environment going forward but recognizes that this is accounted for by placing a weight of only 3% on the experience of this accident year. The Panel acknowledges that there are also significant uncertainties with respect to the accident year 2020 experience. As a result, the Panel finds that the approach adopted by Sonnet is a reasonable balance of the competing uncertainties.

B. Estimated Loss Ratio at current Level (Premium Trends and On – Level Factors)

[46] As an insurer with a growing volume of business, Sonnet's portfolio has undergone a variety of changes by classification in the course of the last few years. Therefore, the premiums collected in the past must be brought to the current rate level in order to avoid double counting of the indicated rate change need. There are several accepted actuarial approaches to achieve this goal, including the parallelogram method, as proposed by the Applicant, and the extension of exposure method, for which the OAG advocates.

[47] The parallelogram approach uses historical premiums and applies factors to those premiums in order to bring the historical premiums to the current rate level. It assumes, *inter alia*, that the distribution of policies written is uniform over time. While not as precise as some other methods, it is nevertheless a well-accepted actuarial methodology and has been used by Sonnet in past filings.

[48] The extension of exposures method is a precise but more labour-intensive process, requiring an insurer to go back into its database and re-rate each policy. This method is only possible if sufficient details are available within the database to accurately determine the premium that would have been charged on each of the historical policies had the current rates and rating factors been in effect at the time. When sufficient and reliable data is available, it may fairly be said that it provides more exact result.

[49] In response to the OAG's questioning through interrogatories, Sonnet advised that it did not have all of the necessary information in order to adopt the extension of exposure method. Therefore, some assumptions would have been required to use that method. Sonnet argues that the better course was to use a monthly parallelogram method to determine the on-level premiums for its rate indication. By request, but without the missing rating characteristics, Sonnet made best efforts to determine the sensitivity of the indications to the different methodologies. Sonnet estimated that, with the caveat that it would not be reflective of some rating characteristics for which blanket assumptions had to be made, adopting the extension of exposures method would decrease the indicated rate change from +11.7% to +9.8%.

[50] Both of these methodologies are *prima facie* acceptable from the NBIB Filing Guidelines point of view and by actuarial standards, though the Extension of Exposures method does give a more precise estimate when sufficient and reliable data is available. In the absence of the data necessary to do so, and where the parallelogram method has consistently been used in the past by Sonnet, the Panel does not find it reasonable or appropriate to reject the continuation of the use of that method at this time. Nevertheless, Sonnet is encouraged to gather all of the required data as it grows and gains market share so that the more precise method can be considered in future filings where appropriate.

C. Expenses – Amortization of Guidewire System

[51] Sonnet recently implemented a new policy administration system for this on-line only business. The cost of the new system – Guidewire – is significant and Sonnet proposes to amortize that cost over several years under the heading of Head Office Expenses. Sonnet argues that this heavy IT cost component is an essential part of its digital platform, website and system. Sonnet argues that the investment in Guidewire results in improved customer digital experience and that it is beneficial to the customer. It therefore includes the costs as part of "Head Office Expenses" in its expense analysis. Sonnet argues that the Head Office expense is appropriately reflective of long-term expected expenses.

[52] The OAG disagrees, arguing that it would be more appropriate for Head Office Expenses to be based on a multi-year average of costs that exclude one-time capital expenses (such as the costs to implement a new policy administration systems). The OAG points out that this expense has already been incurred by

Sonnet, and ratemaking is a prospective exercise intended to align future expenses with future premiums and policies.

[53] Section 4.f.vi of the Board's Filing Guidelines requires insurers to disclose and explain how they treat any non-recurring expenses that create significant variances in one or more years. While the Applicant was compliant with its disclosure obligations, it remains with the Panel to consider whether they are appropriately considered in the Filing.

[54] The Panel agrees with the reasoning of the OAG that the expenses related to Guidewire in this case, have not been established by Sonnet to be incurred in connection with the transfer of risk. Consequently, the treatment of this expense in the manner proposed by Sonnet would result in a rate indication that is not just and reasonable. The expense must therefore be excluded. Sonnet was requested to provide revised indications resulting from the exclusion of that element from Head Office Expenses.

[55] This decision relates to this Filing only. Subsequent filings will be considered and assessed by the Board or a Panel on their merits considering all of the evidence available at that time. In the future, should the Applicant request differing treatment of this type of expense, persuasive evidence would be required to link the expense with the transfer of risk from policyholders and to demonstrate how such an expense is required, in the long-term perspective, for the effective operations of Sonnet, as well as for fulfilling its obligations toward the policyholders.

D. Expenses - Excess Acquisition Expenses – Marketing Costs

[56] As an internet-based company, Sonnet operates differently than most insurers in terms of marketing and acquisition costs. Where a traditional company may incur the costs of broker and contingent commissions, Sonnet incurs other expenses to attract customers. The timing of these marketing expenses does not necessarily, however, line up with the resultant expected increases in business.

[57] These costs are disclosed in the Filing and are calculated as a direct expense load percentage in relation to overall premium. If that percentage is too high, as the OAG argues, then it may be an inappropriate front loading of marketing costs.

[58] Sonnet argues that while its volume of business is lower, expenses appear to be a higher percentage, but as the portfolio grows, the direct expenses will decrease as a percentage of overall premium to align with industry average. Sonnet argues that all of the costs are directly related to servicing prospective policies that Sonnet expects to write.

[59] The OAG takes a differing view, noting that traditional companies who pay a standard commission rate of 12.5% adopt a significantly lower expense rate than Sonnet's direct expense load of 16.8%. The OAG notes that marketing expenses represent a significant portion, 55%, of that 16.8% figure. The OAG argues that Sonnet's inclusion of these marketing expenses, intended to fund growth, in the rate indication calculations imply that the growth is being funded by policyholders while benefits accrue to the shareholders rather than policyholders.

[60] The CAI agrees with the OAG's position, arguing that if Sonnet's approach is accepted, then the growth is being funded by policyholders while the benefits are enjoyed by shareholders. Both the OAG and CAI argue that the expense provision is therefore excessive.

[61] While the Panel does not accept that a direct comparison can easily be made between the 12.5% standard broker commission and Sonnet's marketing direct expenses, it was clear to the Panel that the marketing expenses, in these circumstances appeared potentially excessive. The Panel therefore requested the Applicant to provide additional justifications for the expenses claimed, as noted above.

[62] The Panel reviewed the additional information that was provided by Sonnet, noting that the forecasted direct expense ratios for 2022, 2023 and 2024 were 17.9%, 15.0% and 12.7% respectively. Due consideration was given to the Applicant's responses with respect to marketing costs, along with the goal of reasonable rates balanced with a desire for stability. The Applicant acknowledges that direct costs will diminish to an extent over time and the Panel determined that these costs should appropriately be smoothed out over a longer period, rather than front-loaded.

[63] As a result, the Panel directs the Applicant to modify its direct expense ratio to use 15.0% instead of 16.8%.

E. Return on Equity (ROE)and Return on Premium (ROP)

[64] For the purposes of its indications, Sonnet selected a target ROE of 12% and a target ROP of 7.2%. With the Applicant's proposed rate change, the implied ROE and ROP are 9.53% and 5.46 % respectively.

[65] The OAG argues that the target returns are higher than those allowed in other provinces, such as Ontario, and questions the Applicant's target returns.

[66] Both the CAI and the OAG raise concern that the Applicant's target ROE and ROP are not reasonable in all of the circumstances and higher than those allowed in other provinces.

[67] The Panel is generally aware of studies being commissioned by other regulators elsewhere in the country. However, each jurisdiction operates in a different regulatory and competitive environment. In New Brunswick, this Panel is satisfied that a target ROE of 12% after tax, and a target ROP of 7.2% are reasonable at the present time for this Applicant. The target rate is essential for the consideration of indicated rates. The Panel also takes notice of the implied rate of return. The proposed rate level change is lower than the indicated rate level change and is less than 12% and 7.2% used as targets.

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

F. Return on Investment (ROI)

[69] In this Filing, Sonnet has incorporated a pre-tax investment rate on cash flow (ROI) and discount rate assumption of 2.5% within their rate indication calculations.

[70] The OAG questions Sonnet's selected assumption given that Sonnet's actual average pre-tax returns on investment rates for 2018, 2019 and 2020 were 3.97%, 4.25%, and 4.13% respectively, with an average return of 4.12%. The OAG suggests that Sonnet's selected discount rate assumption is an understatement of expected investment income, resulting in overstatement of rate level need.

[71] Sonnet suggests that the investment yield presented in the P&C Core Financial Statement Return (P&C-1 Financial Reports), relied upon by the OAG, are not the best estimates for the purpose of the

calculations included in the Applicant's rate adequacy analysis. As an alternative to the investment yield, Sonnet provided actual return on equity figures for the years 2017 through 2020 as -3.5%, -2.73%, 1.49% and 8.47%, for a three-year average pre-tax return on equity of 2.41%.

[72] The Panel recognizes that the average or individual yields from 2017-2020 are historical, whereas ratemaking is a prospective exercise. The returns suggested by the OAG are not only historical, but also include capital gains and returns on investments supporting the equity.

[73] The Panel also wishes to address one of the OAG's argument regarding the Canadian Institute of Actuaries: Standards of Practice (CIA SOP). The OAG quotes a portion of the Section 2620.01 of the CIA SOP:

> The best estimate present value of cash flows relating to the revenue at the indicated rate should equal the best estimate present value of cash flows relating to the corresponding claim costs and expense costs, plus the present value of a provision for profit, over a specified period of time.
>
> [Exhibit 23, page 918 of the Record]

[74] The OAG further notes that : "The CIA SOP doesn't exclude any revenues associated with the automobile policy rate indication calculations. Specifically, all expected investment income associated with the automobile policy, including that from all sources of investments (e.g., risk free bonds, corporate bonds, and equities) should be considered."

[75] The Panel wishes to provide additional context, also from the CIA SOP:

> 2620.15 The investment return rate for calculating the present value of cash flows would reflect the expected investment income to be earned on assets that might be acquired with the net cash flows resulting from the revenue at the indicated rate.
>
> 2620.16 Among various possible sets of such assets the actuary would consider
> - Risk free assets of appropriate duration;
> - Fixed-income assets of appropriate duration; and
> - Assets which are expected to be acquired.
>
> 2620.17 The actuary would consider the fact that the provision for profit is not independent of the selected investment return rate and its associated uncertainty.

[76] The Panel cannot find compliance fault in the ROI assumption adopted by Sonnet when the CIA SOP are viewed in their entirety. The Panel deems the Sonnet assumption regarding the ROI as reasonable in these circumstances.

G. Credit Score

[77] In this Filing, Sonnet is proposing to introduce a credit score discount as a rating factor for the determination of automobile insurance premiums. This discount will be offered on all coverages (except Endorsement 44) for customers who provide their consent for their credit score to be checked. The proposed discount rewards customers with high credit score on the basis that there is a strong direct (inverse) relationship between credit score and expected loss costs. As a result, Sonnet contends that by including this rating factor in their rating along with all other factors, rates are more aligned with expected loss costs.

[78] To complete the supporting analysis, Sonnet utilizes the data available to them from the Province of Quebec. Recognizing that the data may not be fully reflective of New Brunswick experience, Sonnet adjusts the impact to be more moderate than what they observe in the Quebec data and commits to use more New Brunswick credit score experience data as it becomes available.

[79] The Panel accepts, as similar panels of the Board have done in the recent past, that credit score-related discounts may be reasonable in the circumstances as there is a reasonable correlation to risk. The Applicant's approach to this rating factor is, on the whole, a reasonable one. The Board will maintain a watchful eye on developments related to this rating factor, subject to any guidance from the Superintendent of Insurance's office.

H. Covid 19

[80] Sonnet's rate indications do not explicitly take into account any impact on the industry arising from the Covid-19 pandemic that have been ongoing since the spring of 2020. Instead, it selected development factors that implicitly unwind the effect on reported claim amounts.

[81] Sonnet also assumes that the pandemic will not impact the future claims costs under the proposed rate program. It is recognized that there remains a great deal of uncertainty on the impact of the pandemic in the months and years to come, and the Panel is satisfied that the Applicant's approach is reasonable. The Panel reviewed the measures taken by Sonnet to ease the strain on policyholders to date, including deferral of premiums, waiving non-payment or NSF repercussions, and amending driving distance categories. The Panel finds all of these measures to be reasonable and responsive to the ever-changing environment. The Board will keep a watchful eye on developments.

4. Decision

[82] 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:

a. Modify the expense assumptions to exclude the Guidewire costs related to the platform amortization from Head Office Expenses; and,
b. Modify its direct expense ratio to use 15.0% instead of 16.8%.

[83] The impact of these changes was calculated at the Panel's request in the additional request for information provided on March 11, 2022. The impact being an amended indicated average rate change from +11.70% to +8.5%.

[84] The Applicant is ordered to incorporate changes to the rate application as set out in paragraph [82] above and is **approved to adopt the proposed average rate change of +8.24% (+7.90% after capping).**

[85] The approved rates will be effective for Phase 1 on April 16, 2022 for new business and May 31, 2022 for renewal business and for Phase 2 on August 1, 2022 for new business and September 15, 2022 for renewals.

Dated at Saint John, New Brunswick, on April 08, 2022.

Mr. Marven Grant, Vice-Chair
New Brunswick Insurance Board

WE CONCUR:

Ms. Rachel Arseneau-Ferguson, Board Member

Ms. Elizabeth Turgeon, LL.B., Board Member

Corrigendum of the Panel Decision

Paragraph 10 - Typographical error in the amended indicated rate; 9.5% has been corrected to 8.5%

Paragraph 83 - Typographical error in the amended indicated rate; 9.5% has been corrected to 8.5%