DECISION **2023 NSUARB 11**
M10813 and M10861

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE INSURANCE ACT

- and -

IN THE MATTER OF AN APPLICATION by **INTACT INSURANCE COMPANY** and **TRAFALGAR INSURANCE COMPANY OF CANADA** for approval to change their rates and risk-classification systems for private passenger vehicles

BEFORE: Jennifer L. Nicholson, CPA, CA, Member

APPLICANT: **INTACT INSURANCE COMPANY**
TRAFALGAR INSURANCE COMPANY OF CANADA

FINAL SUBMISSIONS: November 30, 2022

DECISION DATE: **January 24, 2023**

DECISION: **Applications are approved.**

I INTRODUCTION

[1] On October 20, 2022, Intact Insurance Company applied to the Nova Scotia Utility and Review Board proposing changes to its rates and risk-classification system for private passenger vehicles. On November 18, 2022, Trafalgar Insurance Company of Canada filed an application with the Board seeking to implement the changes submitted by Intact Insurance Company, as revised in the information request process. Trafalgar's rates and risk-classification system are based on the Intact rates. The proposal maintains these relationships. The Board will refer to Intact throughout the Decision for simplicity, but comments will apply to Trafalgar as well.

[2] The companies propose rate changes that vary by coverage and result in an overall increase of 7.5% for Intact and 5.9% for Trafalgar. Both companies proposed adoption of the 2023 Canadian Loss Experience Automobile Rating (CLEAR) tables. The companies also proposed changes to differentials for several rating variables, the introduction of a new rating variable, New Business Type, changes to two endorsement premiums, and adjustments to its renewal premium dislocation capping mechanism. The companies will also revise their automobile insurance manual.

[3] The Board must consider whether the proposed rates and risk-classification system are just and reasonable and in compliance with the *Insurance Act* (*Act*) and its *Regulations*. The Board is satisfied the companies' applications meet these requirements and approves the companies' proposed rates and risk-classification systems.

II ANALYSIS

[4] The companies applied under the Board's *Rate Filing Requirements for Automobile Insurance – Section 155G Prior Approval* (*Rate Filing Requirements*). During Board staff's initial review, they identified several areas where they required additional information or clarification of the material presented. Board staff sent an information request to Intact. Intact's response included an amended application to address some items raised in the information request and to adopt the recently approved 2023 Canadian Loss Experience Automobile Rating (CLEAR) tables. The Trafalgar application reflected these amendments. Board staff prepared a report to the Board with recommendations on the application (Staff Report). Before providing the Staff Report to the Board, Board staff shared it with Intact. Intact reviewed the report and informed Board staff that it agreed with the recommendations.

[5] Board staff examined all aspects of the ratemaking procedure to make the recommendations in the Staff Report and suggested that the Board further review certain issues. Board staff consider that Intact satisfactorily addressed all other aspects of the ratemaking procedure in its application and IR responses.

[6] Board staff reviewed the rate level indications developed by Intact and examined all aspects of the ratemaking procedure, to make the recommendations in the Staff Report. Based on Board staff's review of the filing, there are two issues surrounding the Intact analysis of its rate level needs that arose where additional discussion is required. These issues are (a) loss trends selections and (b) profit provision. All other issues raised in the information request process were successfully resolved.

[7] The Board will examine the following issues in this Decision:

a. Loss trend selections;
b. Profit provision;
c. Proposed rate changes;
d. Proposed adoption of 2023 CLEAR tables;
e. Proposed changes to rating variables;
f. Proposed changes to endorsement premiums; and
g. Proposed changes to renewal premium dislocation capping mechanism.

Loss Trends

[8] The company based their selected loss trend rates primarily on a review of internal Intact experience in Nova Scotia through December 31, 2021. Intact argued that it represents a sizeable portion of the market in the province and that most of its coverages are fully credible. Intact believes its book is large enough to warrant the use of its own data to determine loss trends. For Bodily Injury and Accident Benefits, Intact also considered industry data through June 2021 when making its trend selections.

[9] Intact examined frequency, severity and loss cost separately to make the loss trend selections. The company varied the experience period used to determine the loss trend selections.

[10] Intact selected its base future trend rates that match its past trend rates. Given the recent spike in inflation, Intact examined the impact of the higher inflation resulting from the reduced production from factories, the recovery from the pandemic, and the war in the Ukraine, as well as labour shortages. These elements put pressure on the costs for physical damage related coverages. The company's internal country-wide data has shown significant year over year increases in severity starting in the last quarter of 2021. Increased repair costs, both parts and rental costs, increased vehicle

costs, and difficulty finding replacement vehicles (new or used) were the causes. Intact expects the increased repair costs, and to a lesser extent increased total loss costs to persist through the period for which the premiums are being developed.

[11] To account for this higher inflation expectation, Intact added an amount to the base future trend for physical damage coverages (i.e., PD-Tort, DCPD, Collision, Comprehensive, Specified Perils and All Perils). The selected level reflects the excess of the expected inflation over the country-wide severity trend. The company selected this assumed inflation level to be lower than the level currently being experienced to reflect its belief that inflation levels will abate in the future.

[12] With the release of the industry claims experience data through December 2021, Board staff requested Oliver Wyman (OW), the Board's consulting actuaries, to develop assumptions for loss trends for private passenger vehicles. The Oliver Wyman report recommended adjusting future physical damage trend rates to reflect the actuary's view of inflation, as well as the recent CPI for vehicle maintenance and repair costs in Nova Scotia. The Intact adjustment follows this guidance. The Intact trend selections would produce lower indications than the Oliver Wyman trends as adjusted would produce.

[13] The Board usually would not allow the use of company data solely to develop trends. Given Intact represents about one-sixth of the Nova Scotia market, the Intact experience seems large enough to allow its use to develop trends.

[14] Board staff recommends the Board accept, in the circumstances of this application, the Intact loss trends, including the proposed inflation adjustments, as the

appropriate ones for use in determining the indications to be used as the target to assess the appropriateness of the Intact proposal. The Board agrees.

Profit Provision

[15] In the company's methodology, the underwriting profit margin, permissible loss ratio and premium to surplus ratio (PSR) are not input variables but are outputs of the pricing model. Intact used a model that projects cash flow for a policy using assumptions about expenses, losses, investment income, etc. Intact also has, as model inputs, a target return on equity of 12%, and the percentage of the Office of the Superintendent of Financial Institutions (OSFI) minimum capital test that the company desires to hold.

[16] While the OSFI test is a minimum capital test, OSFI requires companies to hold an even higher percentage. To stay above this regulatory level, Intact notes that it must plan and price for an even higher ratio. For its model, Intact used 200%. This level is consistent with past applications.

[17] If the company experiences loss ratios at this level produced by the model (assuming all other assumptions are met), the company will achieve its 12% target return on equity. The model produces a premium to surplus ratio of 2.07:1.

[18] In recent decisions, the Board has required companies, including Intact, to lower the target return on equity to 10%. This action was taken as a result of Board concerns that, as evidenced in part by the release of the 2012 and 2013 General Insurance Statistical Agency Financial Information Reports, the industry appeared to be earning returns on equity well in excess of the 12% the Board believed it was approving.

[19] The 2014-2019 versions of these reports show negative return on equity for the industry. The Board believes this is a result of many companies not taking full indicated rates coupled with some deteriorating experience, possibly related to inclement weather at the start of 2015. The Board does not believe it is a result of the Board requiring companies to use the lower end of their profit range. As such, the Board has continued to require the 10% return on equity for most companies.

[20] The 2020 and 2021 versions of the report show positive returns. These results may be driven by the reduced claims resulting from lower driving observed during the pandemic combined with a move by companies to take premium increases.

[21] The company's use of a 12% return on equity and a 2.07:1 premium to surplus ratio associated with the 200% of minimum capital test assumption, produces a profit provision of 7.0%.

[22] In the last four major filings, the Board required Intact to use 185% of the minimum capital test in the model along with a 10% return on equity. The change in minimum capital test ratio results in a higher premium to surplus ratio (2.13:1) that compares to the common 2:1. This change would also produce a profit provision, based upon the formula above, of 5.5%, which falls just below the Board range.

[23] When asked why the Board should not use a similar adjustment to return on equity and the percentage of the minimum capital assumption in this application, Intact expressed concerns about the assumptions not being suitable to the current market conditions. Intact also suggested its experience in Nova Scotia was not as good as in the rest of Canada. These arguments are like those made in previous applications, where the Board required the change.

[24] The lower Intact returns on equity and poorer Nova Scotia loss ratios are more likely caused by taking smaller than indicated increases rather than the result of the Board forcing Intact to change its assumptions for return on equity and percentage of minimum capital test. The change to the profit provision remains appropriate for Intact.

[25] Board staff recommends the Board require Intact to use a 10% return on equity and 185% of the minimum capital test as inputs to the model to produce indications to be used as target to assess the proposal. The Board agrees.

Staff Indications

[26] Based upon Board staff's recommendations, the Staff Indications are calculated using all the Intact assumptions except for the use of 10% return on equity and 185% of the minimum capital test. The Staff Indications show an overall all-coverages combined required increase of 10.3%, which is lower than the 12.6% increase suggested using the Intact indications.

[27] Board staff recommends the Board use the Staff Indications as the appropriate target to assess the reasonability of the Intact proposal. The Board agrees.

Comparison of Proposed Rates to Indicated Rates

[28] Intact proposed changes to its base rates that vary by coverage but not by territory. The combined effect is an overall rate level increase of 7.5%. The application of the Intact changes to the Trafalgar portfolio results in an overall increase of 5.9% due to the difference in the mix of business the two companies write.

[29] The proposed rate changes by coverage follow the direction of the Staff Indications, but the size of the changes is different. For Accident Benefits, Collision,

Specified Perils and SEF#44, the proposed rates are higher than the indicated rates, while the opposite is true for other coverages.

[30] The smaller than indicated changes for other mandatory coverage, more than offset the higher than indicated Accident Benefit and SEF#44 changes, leading to a lower than indicated increase for mandatory coverages. The lower than indicated changes for Comprehensive offset the higher than indicated premiums for Collision and Specified Perils. The optional coverage change is, therefore, also lower than indicated. While this result is a cross-subsidy between optional coverages, Board staff does not believe the Board needs to act to address it.

[31] These two mandatory and optional coverage results combine for a lower than indicated overall change and a return on equity that is below the 10% allowed target.

[32] Intact supported its proposed rate changes. Board staff recommends the Board approve the proposed rate changes. The Board agrees.

Other Proposed Changes

Territorial Differentials

[33] Intact did not propose any changes to territories or territorial differentials. Intact did not provide any territorial analysis, nor does the Board require any in these circumstances.

Adoption of 2023 CLEAR Table

[34] To assign rate groups for physical damage coverages and Accident Benefits, Intact uses the 2021 CLEAR (Canada, Collision and DCPD Combined, with extended Vehicle Code (21 years) for Alberta & Atlantic Canada). Both Intact and

Trafalgar proposed the adoption of the 2023 version of this table. Intact off-balanced the impact of the adoption of the table to make the change revenue-neutral.

[35] Board staff recommends the Board approve the proposed adoption of the 2023 CLEAR table and the associated off-balancing for both companies. The Board agrees.

Differential Changes

[36] Intact proposed changes to the differentials for five of its rating variables. The company conducted a one-way analysis to examine the relative loss costs between the various levels of each of the variables being changed. Where the data was not fully credible, Intact used the current relativities as the complement of credibility. The company off-balanced the impacts of the differentials changes through base rates to make them revenue-neutral.

[37] Board staff recommends the Board approve the proposed differential changes, including the changes to the credit-based rating variable. The Board agrees.

[38] The following sections describe the rating variables for which Intact proposed change to differentials:

Years Licensed

[39] Intact continues to observe significant growth in its inexperienced operator segment. Competitive information shows Intact quotes well below the rest of the market indicating Intact rates are very competitive for this segment. The results of the one-way analysis and the competitive review of quotes placed during a recent three-month period both suggested Intact needed to increase its rates for this segment. In making its differential selections, the company applied equal weights to the actuarial analysis and

the results of the competitive review to determine the differential changes for the inexperienced segment. Intact also changed the differentials for some coverages for more experienced drivers based solely on the actuarial analysis.

Years with Company

[40] Based on the actuarial analysis, which showed an opposite trend to the current differentials for DCPD, Intact will remove the variable for DCPD by setting the DCPD differentials to 1.000. The company did not change differentials for other coverages to which the variable applies.

Drivers Per Vehicle

[41] The company currently applies a differential based on the ratio of drivers to vehicles. The differential uses three segments based on this ratio. The first segment reduces rates when the ratio is <= 0.75. For ratios higher than that level but less than 2.0, the base rates apply. Where the ratio exceeds 2.0, the differential increases rates to reflect that the vehicles may be driven more given the number of drivers. The differentials vary by coverage.

[42] Based on the one-way analysis, Intact proposed to remove the variable for all coverages except Bodily Injury by setting the differentials to 1.000. For Bodily Injury, the company will remove the segment which reduces rates (i.e., that differential will be set to 1.000) but will leave the segment that increases rates for more than two drivers per vehicle. The one-way analysis provided supports these changes.

Non-Pay Cancellation

[43] Intact applies a differential that surcharges premiums when a risk has non-payment cancellations in the previous three years. The same differential applies to all

coverages. The one-way analysis suggested the differential needs to increase. Intact applied an increase, which was lower than the overall increase indicated, uniformly to the differential for all coverages.

Credit-Based Rating Variable

[44] In [2020 NSUARB 67], the Board approved the company's credit-based rating variable. The variable provides a discount for better credit scores for those policies where the insured provided consent to the company to do a credit check.

[45] Intact applies the variable to several coverages. The company varies the differentials and the credit score at which the discounts begin by coverage. Intact proposed changes to the starting credit score where the discounts begin. The change results in discounts starting at lower credit scores. The starting points continue to differ across the coverages.

New Rating Variable

[46] Intact proposed the introduction of a new rating variable, New Business Type. New Business risks with no non-payment cancellations receive a 7% discount, which at each subsequent renewal decreases by 1.75% until it reaches 0% at the fourth renewal. Intact states this variable will help offset the proposed rate increase and reduce the impact on the company's competitive position. The company will apply the discount to all principal and occasional operators who qualify.

[47] Intact provided the results of a one-way analysis for new business versus existing business over the last five years. This analysis suggested a discount close to the proposed level could be provided, while existing business would not see a discount.

The stepping-down of the discount to zero over four renewals seems appropriate given this analysis.

[48] Because the variable will only apply to new business, there is no impact on the current book that requires off-balancing. Board staff recommends the Board approve the New Business Type rating variable and the associated differentials that provide the decreasing discount. The Board agrees.

Endorsement Premium Changes

[49] Intact proposed changes to the premiums for two of its endorsements, namely NSEF#20 – Loss of Use Endorsement and NSEF#27 – Legal Liability for Damage to Non-Owned Automobiles Endorsement.

[50] The company noted that higher inflation is being experienced for repairable losses. While the proposed base rate increases reflect the higher inflation outlook, the higher inflation also impacts these endorsements. Higher inflation puts pressure on costs incurred to repair and replace vehicles. Higher rental costs and longer rentals see the per occurrence limits being met more often on NSEF#20. Rising costs to repair non-owned vehicles put pressure on the premium for NSEF#27.

[51] For both NSEF#20 and NSEF#27, Intact will increase the flat premiums that apply for the various limits offered by $10. The company notes this change will align the pricing for the Atlantic provinces (including NS) with that used in Ontario.

[52] Intact offers bundles of endorsements, referred to as Plus Pac Options, which include these two endorsements. No changes are proposed to the discount percentages, but the higher premiums for NSEF#20 and NSEF#27 will increase the premiums for the bundles.

[53] Board staff recommends the Board approve the proposed increase to the premiums for NSEF#20 and NSEF#27. The Board agrees.

Premium Dislocation Capping Mechanism

[54] To manage the dislocation experienced by their clients, Intact and Trafalgar currently apply a 35% premium dislocation cap on premium increases at renewal. Where there has been a new minor conviction during the policy period before the renewal, the cap increases to 45% to allow the impacts of any minor conviction (i.e., loss of conviction free discount or conviction surcharge) to pass through. The cap returns to 35% if, in the next policy period, there are no new minor convictions. If the client has a major or criminal code conviction or has an at-fault claim, intact removes the cap.

[55] Intact proposed to lower the 35% cap on renewal premium increases to 21% if the client has no new minor convictions. Trafalgar will lower its cap from 35% to 14%. For both companies, if the client has a new minor conviction, the cap will continue to increase to 45%.

[56] Intact and Trafalgar also proposed to add a cap on renewal premium decreases. The cap limits renewal premium decreases to 3% unless the risk has an improvement in claims or conviction experience at renewals, or the risk is licensed for ten years or less. In these cases, the renewal decrease cap becomes -20%. Examples of a claims or conviction improvement situation include claims getting older and are no longer considered in the rating because they are more than six years old and convictions getting older and are no longer considered in ratings because they are more than three years old.

[57] To use a cap on renewal premium decrease (i.e., a negative cap), the Board requires companies to demonstrate the premium forgone from the cap on renewal increases will exceed the extra premium collected from the cap on renewal decreases. Intact provided the required evidence and noted the capped overall increase is lower than the uncapped increase for both companies.

[58] For clients that Intact gained from the acquisition of RSA, Intact capped renewal premium increases at 5% and capped renewal premium decreases at -14%. This RSA-specific capping applied as Intact transitioned the risks from the RSA administration system and rates to the Intact system and rates, as those risks renewed.

[59] Intact proposed to remove the RSA specific capping and instead apply the proposed Intact capping to those clients. With the RSA clients on the Intact administration system having all renewed to that system, the single capping approach makes sense.

[60] Intact believes the cap will be in effect on average of one year, but some policies may be subject to the cap for longer.

[61] Board staff recommends the Board approve proposed changes to the premium dislocation capping mechanism, including the removal of the RSA specific cap. The Board agrees.

Other Observations on the Application

Automobile Insurance Manual Changes

[62] Intact proposed changes to its rating and underwriting rules in its automobile insurance manual to reflect the changes noted in the report. The company also made some cosmetic changes to the manual. Trafalgar made similar changes to its manual.

[63] Board staff reviewed the current manuals and the proposed changes, as revised, and found no areas where the companies appear to be in violation of the *Insurance Act* or its *Regulations*.

[64] Board staff recommends the Board approve the proposed changes to the automobile insurance manuals for both Intact and Trafalgar. The Board agrees. The Board directs each company to file a revised manual within 30 days of this Decision.

[65] The financial information included provides comfort that the changes proposed, under Section 155I(1)(c) of the *Act,* are unlikely to impair the solvency or financial well-being of either of the two companies.

Effective Dates

[66] Intact and Trafalgar proposed effective dates of March 7, 2023, and April 7, 2023, for new business and for renewals, respectively. Board staff recommends that the Board approve these effective dates. The Board agrees.

III SUMMARY

[67] The Board finds that the application follows the *Act* and *Regulations*, as well as the *Rate Filing Requirements*.

[68] The Board approves the following:

a) the proposed changes to base rates;
b) the adoption of the 2023 CLEAR tables;
c) the differentials changes for rating variables Years Licensed, Years with Company, Drivers Per Vehicle, Non-Payment Cancellation and the companies' credit-based rating variable;
d) the proposed introduction of the New Business Type rating variable;
e) the proposed changes to premium for NSEF#20 and NSEF#27;

f) the proposed changes to the renewal premium dislocation capping mechanism, and
g) the proposed changes to the automobile insurance manual.

[69] The Board finds the proposed rates and risk-classification systems are just and reasonable, and approves the changes effective March 7, 2023, and April 7, 2023, for new business and for renewal business.

[70] The financial information supplied by Intact, and Trafalgar satisfies the Board, under Section 155I(1)(c) of the *Act,* that the proposed changes are unlikely to impair the solvency of the company.

[71] The applications qualify to set a new mandatory filing date under the *Mandatory Filing of Automobile Insurance Rates Regulations*. The new mandatory filing dates for Intact for private passenger vehicles is October 1, 2024, and for Trafalgar, for private passenger vehicles, is November 1, 2024.

[72] The companies must file an electronic version of their Manuals, updated for the changes approved in this Decision, within 30 days of the issuance of the order in this matter.

[73] An order will issue accordingly.

DATED at Halifax, Nova Scotia, this 24th day of January, 2023.

Jennifer L. Nicholson