DECISION **2017 NSUARB 65**
M07903

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE INSURANCE ACT

- and -

IN THE MATTER OF AN APPLICATION by **CAA INSURANCE COMPANY** for approval to modify its rates and risk-classification system for private passenger vehicles

BEFORE: Murray E. Doehler, CPA, CA, P.Eng., Member

APPLICANT: **CAA INSURANCE COMPANY**

FINAL SUBMISSIONS: April 7, 2017

DECISION DATE: **April 28, 2017**

DECISION: **Application is approved.**

I INTRODUCTION

[1] CAA Insurance Company ("CAA" or "Company") filed supporting documents and materials ("Application") with the Nova Scotia Utility and Review Board ("Board") for approval to modify its rates and risk-classification system for private passenger vehicles ("PPV"). The Application, dated February 28, 2017, was filed on the same date.

[2] Information Requests ("IRs") were sent to the Company on March 14, 2017, and responses were received on March 15, 2017. An additional IR was sent and received on March 22, 2017, along with a follow-up telephone conversation with Board staff.

[3] As a result of a review by Board staff, a staff report dated April 6, 2017 ("Staff Report"), was prepared. The Staff Report was provided to the Company for review on the same date. The Company responded on April 7, 2017, indicating that it had reviewed the Staff Report and other than correcting an error, had no other comments.

[4] The Board did not deem it necessary to hold an oral hearing on the Application.

II ISSUE

[5] The issue in this Application is whether the proposed rates and changes to the risk-classification system are just and reasonable and in compliance with the *Insurance Act* ("*Act*") and its *Regulations*.

III ANALYSIS

[6] The Company sought approval to change its rates and its risk-classification system for PPV. The Application was made in accordance with the Board's *Rate Filing Requirements for Automobile Insurance – Section 155G Prior Approval* ("*Rate Filing Requirements*"). The Company's mandatory filing date was March 1, 2017.

[7] The proposed effective dates are July 1, 2017, for new business and August 15, 2017, for renewal business.

Rate Level Changes

[8] The Company proposed to change its rates that vary by territory and coverage and changes to its risk-classification system. The proposed changes represent an overall rate level decrease of 4%. These changes are based upon an indication for an all-coverages combined rate increase of 8.8%, which varies by coverage.

[9] CAA indicates that the endorsement premiums will increase by 6.6%. This impact, which is not reflected in the overall rate level calculation above, would lower the overall decrease to 3.4%.

[10] In considering the Company's Application, Board staff reviewed all aspects of the ratemaking procedure, including the following:

- Loss trends and the effects of reform (uses trends from Oliver Wyman Dec. 2015 report);
- Loss development;
- Premium (rate group drift) trends;
- Expense provisions, including Unallocated Loss Adjustment Expenses;
- Experience period and weights;
- Credibility standards and complement of credibility;
- Premium to surplus leverage ratio; and
- Profit provision including target and proposed Return on Equity ("ROE")

Based on the review, the issues that required further analysis were the CAA provisions for expenses and the unallocated loss adjustment expenses. Any other issues regarding the indications were successfully resolved in the information request exchange.

Expenses

[11] CAA included an expense assumption that reflected fixed and variable expenses which was well in excess of the industry average expense ratio of 26.1%, as reported in the most recent General Insurance Statistical Agency ("GISA") Financial Information Report. This assumption was close to, but still slightly exceeded the CAA submission to the 2015 GISA report.

[12] The response to IR-6 explained that there was an increase in administration and marketing expenses in 2016 over 2015 and that this higher level continued into the 2017 budgeted expenses. CAA used the 2017 budget expense, suitably reduced for Nova Scotia differences, in the Application. As a result, it appears to Board staff, that the selected expenses, relative to the actual expenses shown in the Application and to those reported to GISA, are reasonable.

[13] The Board approves CAA's expense provision, as filed.

Unallocated Loss Adjustment Expense ("ULAE")

[14] To reflect ULAE, CAA applies a loading factor to its losses. This loading factor was selected after consideration of the ratio of the ULAE to paid and incurred losses over the past 5 years. To develop this number, the ULAE and loss values for Ontario and the three Atlantic provinces were combined.

[15] As part of the work to develop the 2015 Financial Information Report, companies are required to provide ULAE information to GISA. An extraction of this information for CAA from the Nova Scotia master files from GISA suggest that a much lower value would be more appropriate. In response to questioning, CAA stated the GISA reporting for Nova Scotia includes only those adjustment expenses that were actually spent in Nova Scotia. A significant amount of the case adjustment is done in Ontario and those expenses are allocated for GISA Financial Information Report purposes to Ontario, giving rise to the smaller Nova Scotia number.

[16] The approach used by CAA for pricing determines a loading factor by dividing the costs from Ontario and all three Atlantic provinces across the claims for those provinces. The Company then applies this factor to the Nova Scotia claims to get the proper allocation of the costs for this province. This method seems reasonable to Board staff who would expect such an approach to be used for reporting to GISA.

[17] The CAA submissions to the Financial Information Report for 2013 and 2014 show volatile results, but if the three years are combined, the ULAE would be very close to the assumed level.

[18] As a result, Board staff has accepted the value used by CAA and do not recommend any changes to it at this time. CAA has indicated that the Company will be investigating the GISA Financial Information Report process to see if it is being done properly. That investigation will be done outside of the review of this Application.

[19] The Board approves the use of CAA's ULAE value in developing the indication.

Comparison of Proposed Rates to Indications

[20] A review of the proposed changes by coverage, against CAA's indications, which the Board has accepted as reasonable, shows, with the exception of Bodily Injury and Property Damage-Tort, the changes are in the same direction. The magnitude of the changes, however, is different. Other than for SEF#44, the proposed premiums are lower than the indicated premiums.

[21] For SEF#44, the indicated reduction would see the current $13 premium fall to $7.50. This level would be well below the industry average of $20. Such a drastic reduction may not be prudent and CAA, therefore, proposes to leave the SEF#44 rate unchanged at this time.

[22] Approving the proposal would result in a negative return on equity ("ROE") which is a concern to the Board, as it could affect financial solvency of the Company. The ROE results from the Company's decision to propose rates well below the indicated level, especially for Bodily Injury and Accident Benefits. When questioned about this decision, CAA explained:

> CAA's Bodily Injury loss performance was better than the industry during the experience period. … According to pre-credibility indication, we proposed a mild decrease for Bodily Injury to improve CAA's competitive position and grow business in Nova Scotia.
>
> Similarly, CAA's AB loss performance was better than the industry during the experience period. … CAA proposed to take smaller increase than indicated to avoid significant pricing fluctuation and to maintain pricing stability.
>
> We aimed to improve our competitive position and grow our business in Nova Scotia. Combining that CAA's loss experience is outperforming the industry in Nova Scotia and CAA's overall performance in recent years, we proposing [sic] rates that results in an ROE of -3% even though the target is 10%.
>
> [Response to Q1, Q2 and Q4 of IR-1]

[23] CAA is willing to accept the negative ROE in this circumstance because a large part of the indicated increases for Bodily Injury and Accident Benefit are a result of

the use of industry data as the complement. CAA appears to be "outperforming the industry" and the Company is recognizing this, along with its desire to grow its volume of the automobile insurance business in the province.

[24] Board staff support CAA's proposed changes and the Board approves them.

[25] CAA proposed some modifications to its risk-classification system. These changes give rise to impacts on rates. CAA did not off-balance these impacts but considered them when selecting the proposed changes to the base rates. These modifications are discussed below in this Decision.

Other Proposed Changes

Territorial Definitions and Differentials

[26] CAA proposed the introduction of a new rating territory, 1D, by a finer segmentation of its current 1B territory. The decision to create the new territory is based upon an analysis of the claims experience in the territories as well as consideration of the CAA plan to grow its business. The experience within the new territory was suspected to be worse than the experience of the other portion of the current territory 1B. CAA provided evidence that showed that the loss ratio over the past five years was higher for the new territory than for the rest of the current 1B. As such, there is support for creating the new territory.

[27] CAA conducted an analysis of its territorial differentials and determined credibility-weighted indicated changes. CAA proposed changes to its differentials that generally followed the indications but the magnitude of the proposed change was capped

to limit premium dislocation. The cap varied by coverage. A higher cap was applied to those coverages where a larger provincial wide change was indicated. In this manner, the Company is able to allow a more reasonable differentiation in territorial indications for these coverages than would have been possible if a smaller cap had been used. Any deviation from the capped indicated change was made to address market concerns.

[28] The proposed changes to the differentials produced an overall small increase. This increase was not off-balanced, but rather was taken into consideration when the overall change to base rates was determined.

[29] Board staff support, and the Board so approves, the introduction of territory 1D, the change to territory 1B and the selected territorial differentials.

Individual Rating Plan

Introduction

[30] CAA proposes to introduce an individual rating program by unbundling the elements of its current class rating variable, removing its Experience Driving Discount (which is redundant in the new approach) and adding a rating for occasional female operators who are licensed less than 9 years.

[31] The new program will use the following variables:

- Driver Type,
- Use of Vehicle,
- Annual Mileage,
- One-Way Mileage (e.g. commute); and
- Years Licensed/Gender as rating variables.

[32] Two sets of factors for each rating variable were determined. One set applies to the components of Third Party Liability and the other set applies to Collision.

To develop the factors, CAA used a one-way analysis to determine differentials for Driver Type and Vehicle Use because there was limited data available. One-Way Mileage, Annual Mileage and Years Licensed/Gender differentials were determined based on the current class differentials and inforce exposure distribution. Experienced driver discounts were also taken into account in the determination of the years licensed/gender differentials.

Driver Type

[33] CAA proposes to segment drivers into principal drivers and occasional drivers (occasional operators are those licensed for less than 9 years). The principal operators are not segmented by gender, but that is not the case for the occasional operators.

[34] CAA conducted an analysis of the indicated differentials using industry data and current differentials. Because CAA does not currently use a differential for occasional female operators, the Company relied on industry data and relativities that CAA uses in Ontario to establish the new differentials.

Vehicle Use

[35] This variable is used to segment risks by how the vehicle is used. The available segments are “Pleasure only” (i.e. no commute), “Commute”, and “Business”. To develop differentials for these segments, CAA relied upon industry experience and current CAA Class differentials.

One Way Mileage

[36] This variable captures the length of the commute for the main use of the vehicle. The commute length is split into two categories, “up to 16 km” and “16 km or more”. CAA relied on its current class differentials to establish relativities for the two categories by determining the average differentials for each category based on CAA exposures. The differentials were then rebased so that the “up to 16km” commute value was set to one.

Annual Mileage

[37] This variable captures the mileage that the vehicle is typically driven during a year. This amount is categorized as “up to 16,000 km” and “16,000 km or more”. As with One Way mileage, CAA relied on its current class differentials to establish relativities for the two categories by determining the average differentials for each category based on CAA exposures. The differentials were then rebased so the “up to 16,000 km” category value was set to one.

Years Licensed

[38] To determine this final element of the unbundling process, CAA split its exposures by years licensed and gender. For each year licensed and gender combination, an intermediate premium was determined by applying the first four factors identified above to the base premiums. The current premium for the combination was divided by the intermediate premium to determine an adjustment factor. By multiplying these factors by the Experienced Driver Discount, a raw differential is developed. CAA

selected its differentials for this variable after considering the industry relativities implied by GISA data and what potential dislocation could occur.

Conclusion

[39] Because these factors will now reflect the experience differences that are currently captured in the Experienced Driver Discount, CAA proposes to remove this discount in order to avoid any redundancy.

[40] Board staff support CAA's proposal for its new rating variables, the associated differentials and the removal of the Experience Driver Discount.

[41] The Board approves the new rating variables, the assigned differentials, and the removal of the Experienced Driver Discount as proposed.

Stability Discount

[42] CAA is introducing a Stability Discount that would see a client who was with a broker, or the same insurance company, for the past three years, receive a 5% reduction in premiums, excluding the endorsement premiums. CAA indicates that many of its competitors offer this discount. In response to questioning, the Company indicated that the level of the discount was set based upon a loyalty discount offered by a rival insurance company.

[43] When asked why an insured who was with a broker or insurance company for the past three years warrants a discount, CAA explained:

> 3 or more continuous years with previous broker or insurer can demonstrate the loyalty and stability. We value the predictive behavior of this risk group because they are stable and often can reduce our potential exposure to claims. We would like to reward their stability with better premium.
>
> [Response to Q22 of IR-1]

[44] The Company also indicated that once someone is eligible for the discount, it will continue to apply until the policy is cancelled.

[45] CAA stated that the introduction of this discount would lower the aggregate premiums by a small amount. This was not off-balanced but was considered as the overall changes were determined.

[46] Board staff support, and the Board so approves, the proposed Stability Discount, as filed.

Introduction of All Perils Coverage

[47] CAA does not currently offer All Perils coverage and is proposing to add it. All Perils offers coverage that incorporates those provided by Comprehensive and Collision. As such, CAA proposes to set its premiums for this coverage equal to the sum of the Comprehensive premium and the Collision premium that would apply, after the application of any discounts/surcharges which would be eligible for the risk.

[48] The Board approves the addition of All Perils coverage and the proposed calculation of the premium, as filed.

Endorsement Bundles

[49] CAA proposes to introduce an endorsement bundle that reduces the premiums when a customer purchases a combination of two or more of the following endorsements:

- NSEF#20 – Loss of Use;
- NSEF#27 – Liability for Damage to Non-Owned Vehicles; and
- NSEF#43R/NSEF43R(L) – Waiver of Depreciation/Limited Waiver of Depreciation Specified Lessee

[50] The proposed bundle pricing will see the purchaser of two of these endorsements receive a 10% discount on the combined endorsement premiums. The discount increases to 15% if all three are purchased together.

[51] This change brings the CAA offer in line with what the Company offers in Ontario. It rewards those clients who purchase more coverage. CAA provided an estimated number of risks that would be effected and estimated the premiums for these endorsements would decline by about 5% and the overall premium impact would be a very small reduction.

[52] Board staff supports, and the Board approves, CAA's proposal for the proposed bundles and associated discounts, as filed.

NSEF#43 Rating Algorithm

[53] CAA offers the Waiver of Depreciation/Limited Waiver of Depreciation Specified Lessee endorsements to its clients for new vehicles. CAA allows a vehicle purchased as a demonstrator to be treated as a new vehicle if it had been driven less than 5,000 km. The present endorsement waives the depreciation if the loss or damage occurs with 24 months of the purchase/lease date. The Company proposes to extend this period to 60 months.

[54] Lacking experience data in Nova Scotia to determine the proposed premiums, CAA has relied on the rating model used in Ontario. This model was approved

by the Financial Services Commission of Ontario to be effective for new business on September 15, 2016, and for renewal business on November 1, 2016.

[55] The new rating model varies the premium by the rating group used for Collision coverage using a band approach (e.g. rate groups 24-27 are grouped together and receive the same premium). The premium also varies with the time since the vehicle was purchased. Premiums increase as the amount of depreciation being waived increases.

[56] The premiums, in all cases, are higher than the current $19 for the 24-month coverage. The total premiums collected by the Company for this endorsement will increase by about 350%, but this is to be expected given the longer coverage period for which the client will be eligible to benefit from the waiver and the associated increase in risk exposure to CAA.

[57] Board staff supports CAA's proposal to the changes for the extended coverage and the pricing algorithm for NSEF#43R/NSEF#43R(L).

[58] The Board approves the proposed changes, as filed.

Rating Group and Rate Group Differential Changes

[59] To assign rate groups for physical damage coverages, CAA currently uses the 2016 Canadian Loss Experience Automobile Rating ("CLEAR") (Canada, Collision and DCPD Combined, with extended vehicle code (21 years) for Alberta & Atlantic Canada). In this Application, CAA proposes to move to the 2017 version of the same table. The impact of the change was not off-balanced, but rather was considered when CAA determined its proposed changes.

[60] In addition to the adoption of the new table, CAA also proposes to eliminate the use of the published CLEAR rate group differentials and instead will use a modified version of those differentials. CAA explains that its brokers were having difficulty providing competitive quotes for a specific group of vehicles, most of which fall within the rate group 29-44 band. CAA, therefore, proposes to alter the slope of the rate group differentials after 29 to grow less steeply, resulting in lower, more competitive premiums.

[61] It is expected that the use of the CLEAR rate groups requires the use of the CLEAR differentials for those rate groups as that, in part, is how the table was derived. However, other companies with approved rates in Nova Scotia, alter either the differentials or modify the rate groups in some manner. It would not appear to be reasonable to force CAA to continue the use of the CLEAR differentials, while allowing others to alter them.

[62] Within the rate group band of 29-44, the new differentials result in discounts of between one and 17%.

[63] Board staff support CAA's proposal to adopt the 2017 version of its selected CLEAR table and its proposed revised differentials.

[64] The Board approves the adoption of the 2017 CLEAR table and use of the modified differentials.

Rate Manual Review

[65] Apart from those changes noted above and those required to implement the proposed revisions to rates, risk-classification system and rating rules, CAA is making a few other changes to its rate manual to provide more clarity. In particular, CAA is

expanding the section on endorsements to better describe what protection each endorsement provides.

[66] Board staff have reviewed the Rate Manual on file and the proposed changes and found no instances where the Company is in violation of the *Regulations*.

IV FINDINGS

[67] The Board finds that the Application complies with the *Act* and *Regulations*, as well as the *Rate Filing Requirements*.

[68] The financial information submitted by the Company satisfies the Board, pursuant to Section 155I(1)(c) of the *Act,* that the proposed changes are unlikely to impair the solvency of the Company.

[69] The Board finds the proposed rates are just and reasonable.

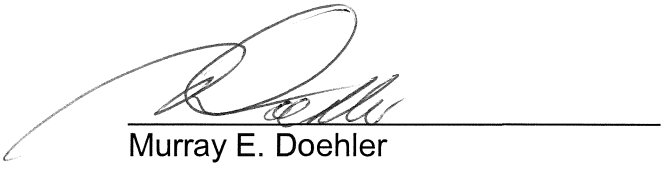
[70] The Application included full actuarial indications and the required territorial analysis; therefore, it qualifies to set the new mandatory filing date for PPV for the Company to March 1, 2019.

[71] The Board approves the effective dates of July 1, 2017, for new business and August 15, 2017, for renewal business.

[72] The Company is required to file an electronic version of its updated Rate Manual within 30 days of the issuance of the Order in this matter.

[73] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 28th day of April, 2017.



Murray E. Doehler