DECISION

2017 NSUARB 79
M07909

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE INSURANCE ACT

RA

- and -

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

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

APPLICANT: **ALLSTATE INSURANCE COMPANY OF CANADA**

FINAL SUBMISSIONS: April 19, 2017

DECISION DATE: **May 25, 2017**

DECISION: **Application is approved.**

I INTRODUCTION

[1] Allstate Insurance Company of Canada ("Allstate" 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 March 1, 2017, was filed on March 2, 2017.

[2] Information Requests ("IRs") were sent to the Company on March 16, 2017, and April 13, 2017, and responses were received on April 5 and 18.

[3] As a result of a review by Board staff, a staff report dated April 18, 2017, ("Staff Report"), was prepared and provided to the Company for review on the same day. The Company responded on April 19, 2017, indicating that it had reviewed the Staff Report and had no comments other than to request a change to the effective dates.

[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 revised proposed effective dates are June 20, 2017, for new business and August 20, 2017, for renewal business.

Rate Level Changes

[8] Allstate proposes to make changes to base rates and differentials that vary by territory and coverage as well as to make changes to its risk-classification system (including rating rules) that result in an overall all-coverages combined increase of 5%. These changes are based upon a much larger indication for an all-coverages combined rate increase.

[9] Allstate received approval to split its current Third Party Liability ("TPL") into Bodily Injury, Property Damage-Tort and Direct Compensation Property Damage ("DCPD") effective April 1, 2013. While TPL is shown as a single element, the Application proposes to apply those changes to the split rates approved by the Board. Due to lack of data, the indications were shown for TPL combined. They were developed, however, by breaking down TPL experience into Bodily Injury and Property Damage (i.e. Property Damage-Tort and DCPD combined). Until the General Insurance Statistical Agency publishes DCPD experience, this is an acceptable approach.

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

- Loss trends (uses Oliver Wyman ("OW") selections from December 2015 based report);
- Effects of Reform (Minor injury cap in 2010 and AB reform in 2012);
- Loss development;

- Premium (rate group drift) trends;
- Expense provisions, including Unallocated Loss Adjustment Expenses;
- Experience period and weights;
- Credibility standards, procedures, and the complement of credibility;
- Premium to surplus leverage ratio; and
- Target and proposed Return on Equity ("ROE")

[11] Based on Board staff's review of the filing, the only issue that arose surrounding the Allstate analysis of its rate level needs where the Board might consider alternate assumptions was the profit provision. Any other issues raised, including concerns about the expense provisions and the loading for unallocated loss adjustment expenses, were successfully resolved through the information request process.

Return on Equity

[12] Allstate uses a target ROE of 12% in its indications. Based upon its selection of a premium-to-surplus ratio of 1.7:1 (consistent with the prior application although the ratio by coverage has changed slightly) and the investment return on surplus assets, the 12% ROE results in a profit provision of 9.8%. Using a more common 2:1 ratio and the Board ROE range of 10%-12%, along with the Allstate investment income on surplus asset assumptions, the Board range for reasonable profit provision would be in the 6.8%-8.3% range. Allstate's use of the high end of the ROE range, along with a lower premium-to-surplus ratio, results in a profit provision that falls outside this range.

[13] The Board in recent decisions has expressed its concern, as reported in the 2012 and 2013 GISA Financial Information Reports, that the industry appears to be earning profits in Nova Scotia that exceed the approved level. To address this concern, the Board has forced other companies to use a 10% ROE.

[14] The 2014 and 2015 versions of these reports show negative ROEs for the industry for private passenger vehicles. Board staff believe this is likely more a result of many companies, in the past, not taking the full indicated rate changes coupled with some deteriorating experience associated, in part, with inclement weather at the start of 2015. It is not all attributable to the Board forcing companies to the lower end of an acceptable profit range. As such, the Board has continued to require the 10% ROE for companies unless they can demonstrate they are different from the industry.

[15] In response to an IR about why the Board should treat the Company differently from others, Allstate stated:

> In reference to the Roth Paper and the U.S Supreme Court Case, "Hope Natural Gas", Income / return on equity should be commensurate with returns on investments in other enterprises having corresponding risks and be sufficient to attract capital and maintain credit.
>
> Our primary capital provider, our parent company requires us to make 13% ROE, which means the cost of capital for each province and line should attain that level, else it shows a sign that the province is not profitable enough to operate in. Comparing against other financial institutions such as banks, which are making a much higher ROE with comparable risks, forcing such low returns may lead to withdraw of capital and threaten coverage availability in the province.
>
> [Response to Question 2 of IR-1]

[16] A comparison of industry loss ratios, included in the Application, suggests the experience for Allstate has been better than for the industry as a whole. Allstate stated:

> Loss experience in general has been favourable due in part to the pricing and underwriting initiatives to focus on obtaining and retaining lower cost business. The industry loss ratio is adjusted for Allstate's mix of business. The adjustment is lowering the industry loss ratio, which is a testament to Allstate's better mix of business.
>
> [Response to Question 13 of IR-1]

[17] The financial information provided in section 12 of the application shows that the loss ratios for Nova Scotia, until recently, have been good. For all the years shown, they have been better than those observed by the Company in the rest of Canada

for automobile insurance. Board staff have concluded that the use of a 10% ROE, as ordered for recent Allstate applications, remains appropriate. The view is also consistent with that in a concurrent application before the Board for Pembridge Insurance Company, a sister company to Allstate.

[18] Using a 10% ROE along with the Allstate selected premium-to-surplus ratio, which by itself is providing some additional provision to address the Company's concerns, results in a profit provision of 8.0%. This level falls into the Board range, albeit closer to the higher end.

[19] Allstate provided indications with all original assumptions except for the use of a 10% ROE. The change resulted in a drop of about 3% in the indicated overall rate level increase.

[20] Board staff support the use of a 10% target ROE when developing the indicated rate changes for comparisons instead of the Allstate selection of 12%. This recommendation is consistent with the staff recommendations made in the previous Allstate applications regarding the level of ROE to be allowed in the indications. The Board agrees with this suggestion.

Comparison of Proposed Rates to Indications

[21] A comparison of Allstate's proposed changes shows that they are all in the direction of the indicated changes using the lower ROE. The magnitudes of the proposed changes, however, are much smaller than indicated. Allstate explains this, as follows:

> Due to our overall proposed rate level change is only a fraction of the overall rate indicated rate level change, we are unable to take the full indicated rate level change for coverages. We are concerned with potential dislocation and therefore only proposing a fraction of the overall indicated rate level change.

> Given the high indicated rate change, Allstate plans to take increases gradually and will consider filing for rate changes more frequently than the mandatory schedule.
>
> [Response to Questions 3 and 4 of IR-1]

[22] Given the proposal is for a smaller overall increase than indicated, the proposed rates will produce a negative ROE.

[23] The Company states the 12% ROE target is not achievable in one rate change without some large dislocation. Allstate plans to gradually implement rate increases to achieve its target and may approach the Board before its next mandatory filing to accomplish this goal.

[24] While there may be concern about approving rates that result in a negative ROE, Board staff commented that in the circumstances of this Application, the Board does not need to intervene and recommends approval.

[25] Board staff also recommends that the Board should carefully examine the next filing provided by Allstate, and if the indications continue to require double digit changes, the Board should ensure the proposed changes move the rates closer to the indications at that time.

[26] The Board approves the proposed rates, as filed.

Other Proposed Changes

Territorial Differentials

[27] To address concerns about having most of its exposures in a single territory, Allstate proposes to split territory 08 into three separate territories; namely, 08, 09 and 10. To make the split, Allstate identified a number of Forward Sortation Areas (i.e. the first three digits of the Postal Code) that would be relocated from the current territory to

the two new territories. The new territories are contiguous, as shown on the required map. The split also results in each of the new territories having a similar number of exposures.

[28] As part of its indications, Allstate undertook an analysis of indicated rate changes for each of its territories, including the two new ones.

[29] While the indications suggest that changes could be made in most territories, with a number actually indicating reductions should be taken, Allstate chose to leave the differentials for all territories the same except for the new ones, (i.e. 09 and 10). For these two new territories, the changes partially address the differences in experiences between the current and proposed rates. To support the proposed changes, Allstate provided the following:

> Allstate's main concern was that [most] of the book is written in one territory. Given that our proposed rate change already increases rates by 6.2% for territory 10, we do not wish to lower the base rates for other territories to minimize dislocation. Allstate's plan is to gradually differentiate territories 8, 9 and 10 to their full indicated rates before adjusting the other territories.
>
> [Response to Question 14 of IR-1]

[30] If Allstate were to lower the rates in other territories as is indicated to maintain the selected increase, the impact of such changes would be off-balanced resulting in increases to base rates and the potential for an even larger dislocation of clients. It is this additional dislocation that Allstate wishes to avoid.

[31] Rather than off-balancing the impact of the changes to the territory 09 and 10 differentials through the base rates, Allstate considered this impact, which is estimated to be very minor, when it made its selection of the overall change.

[32] Board staff support Allstate's proposal to create the new territories and to adjust the differentials only for them. The Board approves both the proposed new

territories and the associated differentials, and the proposal to leave the other territory differentials unchanged, as filed.

Vehicle Use Differentials

[33] Allstate currently has a series of differentials that apply based upon how the vehicle is used (Business, Farmer, Pleasure, and driving to/from Work). For the non-Business segment, these factors are further refined by the length of daily commute and the annual kilometers driven.

[34] Allstate proposes to expand the annual kilometre bands into finer segments of 2,000 km up to 20,000 km. Allstate also proposes changes to the differentials by coverage in increments of 4,000 km.

[35] The changes are based upon the indicated changes produced by Allstate when it undertook an analysis. However, because of a lack of data in the 2,000 km segments, the analysis was conducted using 4,000 km increments instead.

[36] Allstate did not explicitly off-balance the impact (a very minor change), but rather considered it as it made its overall change selection.

[37] Board staff support Allstate's proposed changes to this rating variable and its differentials. The Board approves them, as filed.

Minor Conviction Surcharge

[38] Allstate currently applies a 10% surcharge when a client is convicted of a minor traffic violation (for example, speeding, but not at a high enough level to trigger treatment as major or serious). For subsequent such violations, the surcharge increases

(e.g. two violations – 30% surcharge, three violations – 60% surcharge, four violations – 85%). In this Application, Allstate proposes to increase the surcharge for one violation to 15% while leaving the surcharges for two and up unchanged.

[39] Based on this, the Allstate proposal moves the Company's first minor violation surcharge closer to its competitors.

[40] Allstate also provided some analysis to show the indicated change to its surcharges based upon its own data. This data suggests that the surcharge of two minor violations is too high (i.e. the indication is for a reduction). Allstate explains its decision to leave this unchanged:

> Allstate Ontario recently changed their underwriting rules to decline new business with 3 minor convictions or more within the last 3 years. Although our results do not show that in Allstate Nova Scotia, we wish to remain cautious.
>
> We also see that Aviva and Intact have similar underwriting rules in Nova Scotia:
>
> [Response to Questions 17 of IR-1]

[41] Allstate did not explicitly off-balance the impact (a very minor change), but rather considered it when it made its overall change selection.

[42] Board staff support Allstate's proposed change to its minor conviction surcharge. The Board approves it, as filed.

Rating Rule Changes

[43] Allstate proposes to expand its "Race or Speed Test" rule and to impose a restriction on the use of the automobile on a racetrack or in race-like situations. The last change had outlined that a "race or speed test" does not require another competitor or a timing device. The latest change was precipitated by recent claims involving a single vehicle on a racetrack. It also includes some additional scenarios where a vehicle is used

on a closed course for advanced performance driving testing or is used in a contest. Allstate will decline such risks.

[44] Allstate proposes to decline customers who have verbally or physically abused an employee of Allstate or an employee within the Allstate Canada group, where that abuse was reported to security, human resources and/or police.

[45] Allstate uses a risk point calculator to determine, in part, the acceptability of a risk to the Company. Allstate proposes to include a threshold to the allowable points. This does not represent a change from current practice; it only clarifies the rule by putting it into the rate manual.

[46] Allstate also proposes a change to allow vehicles rated in the Farmers class to qualify for the Elite rating. This change is being made for consistency across jurisdictions and is able to be made as the previous systems limitations have been removed. Allstate advises it currently only has one Farmers class policy that would qualify for the Elite rating.

[47] Finally, Allstate proposes to add a declination rule for risks that were cancelled for Breach of Statutory Conditions. Such risks will no longer be written. This change is being made to bring Allstate in line with other Allstate Canada Group companies. There is no prohibition on the declination of such a risk in the *Regulations*.

[48] Board staff state that Allstate has provided sufficient support for each of the proposed changes and each seems reasonable in the circumstance. They also do not violate the *Insurance Act* or its associated *Regulations*.

[49] The Board approves the changes, as filed.

Rate Manual Review

[50] Board staff have reviewed the Rate Manual on file and found no instances where the Company is in violation of the *Regulations*. The Company proposed no changes to its Rate Manual other than those necessary to effect the changes noted in this Decision.

IV FINDINGS

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

[52] 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.

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

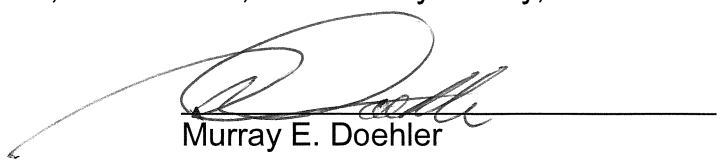
[54] The Application included full actuarial indications and the required territorial analysis; therefore, it qualifies to set the new mandatory filing date for PPV for the Company to March 1, 2019.

[55] The Board approves the effective dates of June 20, 2017, for new business and August 20, 2017, for renewal business.

[56] 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.

[57] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 25th day of May, 2017.



Murray E. Doehler