DECISION

2017 NSUARB 89
M07950

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE INSURANCE ACT

- and -

IN THE MATTER OF AN APPLICATION by **FACILITY ASSOCIATION** for approval to modify its rates and rating rules for school buses

BEFORE: David J. Almon, Member

APPLICANT: **FACILITY ASSOCIATION**

FINAL SUBMISSIONS: May 17, 2017

DECISION DATE: **June 8, 2017**

DECISION: **Application is approved.**

I INTRODUCTION

[1] Facility Association ("Facility" or "Company") filed supporting documents and materials ("Application") with the Nova Scotia Utility and Review Board ("Board") for approval to modify its rates for school buses. The Application was filed electronically on March 15, 2017, and the original documents were received on March 16, 2017.

[2] Information Requests ("IRs") were sent to the Company on May 2 and May 10, 2017, and responses were received on May 9 and May 10, 2017, respectively.

[3] As a result of a review by Board staff, a staff report dated May 12, 2017 ("Staff Report") was prepared. The Staff Report was provided to the Company for review on May 12, 2017. The Company's response was received on May 17, 2017, indicating that it had reviewed the Staff Report and had no additional 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 rating rules 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 rating rules for school buses. The Application was made in accordance with the Board's *Rate Filing Requirements for Automobile Insurance – Section 155G Prior Approval* ("*Rate Filing Requirements*").

[7] The Company also proposed changes to rating rules which apply to school buses insured by Facility.

[8] The proposed effective date for both new business and renewal business is 100 days after the Board's issuance of an Order approving the rates, rounded to the first of the following month.

Rate Level Changes

[9] The Company proposed to change its rates and rating rules. The average annual per vehicle cost impact is a $64.00 increase in premiums. This is an increase in total annual premiums to $1,524.00.

[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;
- Loss development;
- Credibility standards and procedure;
- Premium (rate group drift) trends;
- Expense provisions, including Unallocated Loss Adjustment Expenses;
- Experience period and weights;
- Premium-to-surplus leverage ratio; and
- Target Return on Equity.

[11] Based on Board staff's review of the Application, the only issues that arose concerning the Facility analysis of its rate level needs where additional review is required are:

(a) the selection of loss trends; and,

(b) the profit or cost of capital provision.

[12] All other concerns that were raised in the IRs were resolved satisfactorily through that process.

Loss Trends

[13] When industry claims experience data was released, Board staff requested Oliver Wyman ("OW"), the Board's consulting actuaries, to develop assumptions for loss trends for commercial vehicles. While examining 15 years of data, because commercial data tends to be less credible, OW selected trends for loss costs focusing on 10 years of data. The analysis included a review of frequency and severity trends in addition to loss cost trends.

[14] OW selected future trend rates that matched its past loss trends.

[15] Facility selected loss trends that differ from those selected by OW. Facility based their selected loss trends primarily on a review of Nova Scotia industry experience through December 31, 2015. Facility reviewed loss experience excluding Allocated Loss Adjustment Expense ("ALAE") from 1996-2015 to develop its "indemnity only" loss cost trend selections. The timeframe is longer than that used by OW.

[16] For some coverages, Facility varied its selections for past and future trends. It also changed the starting point of the future trend based upon its analysis.

[17] Board staff produced, for the Board's review, a chart comparing the Facility and OW selections, which indicate where the OW selections are more than 1.5% different than the Facility selections.

[18] Facility provided indications using the OW commercial vehicle trends. There are significant differences between the Facility and OW indications. The smaller changes for mandatory coverages are offset in part by the higher change for Comprehensive and Specified Perils. The overall difference is less than 2%.

[19] Because the overall results are reasonably close, Board staff recommended the Board allow Facility to use its own trends when developing the indications.

[20] The Board would note that a public hearing is scheduled for the fall of 2017 for taxis, for which Facility also uses commercial vehicle loss trends. As part of the issues to be resolved in that application, the Board will make a determination on what trends are appropriate. In the meantime, to avoid prejudicing that decision, the Board staff recommendation should only be applied in the circumstances of this Application and should not be cited as support for use in future filings (including the taxi filing).

Return on Equity

[21] Facility included a cost-of-capital provision using a 12% after-tax return on equity ("ROE") and a 2:1 premium-to-surplus ratio. Using the investment return on surplus assets, which Facility sets based upon current market yields, the profit provision expressed as a percentage of premiums is about 8.5%. Board staff believes Facility's assumed investment return on surplus assets should be higher, based on the fact that the companies holding surplus to back Facility's assets are not investing at current market yields.

[22] In recent decisions, the Board has required companies to lower the target ROE 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 ("GISA") Financial Information Reports, the industry appeared to be earning ROEs well in excess of the 12% the Board was approving.

[23] The 2014 and 2015 version of these reports show negative ROEs for the industry. This result is likely more a result of many companies not taking full indicated rates coupled with some deteriorating experience in part related to inclement weather at the start of 2015, as opposed to the result of the Board forcing companies to the lower end of its profit range. As such, the Board has continued to require the 10% ROE for most companies.

[24] In past filings, the Board has required Facility to reduce its 12% assumption to 11% which is higher than that ordered for other companies.

[25] Facility provided indications using the 11% ROE as an alternative and Board staff recommended that the Board continue to require Facility to use the 11% ROE instead of its selected 12%. The Board agrees.

Staff Indications

[26] Based upon the recommendations to use an 11% ROE, the Staff Indications compare to the Facility original indications. Board staff recommended that the Board use the Staff Indications as the appropriate target against which to assess the appropriateness of the Facility proposal.

Comparison of Proposed Rates to Recommended (Staff) Indications

[27] The next step for the Board is to determine, based upon the Staff Indications, whether the proposed rate changes are just and reasonable.

[28] The overall proposed change is for a larger increase than produced by the Staff assumptions, which results in a proposed ROE, under the Staff assumptions, of 11.8%, which falls in the Board range, but is above the 11% recommended.

[29] Board staff notes that forcing Facility to reduce the rates to achieve a return no higher than 11% would see the average change decrease from $64 to $57, or a $7 difference.

[30] Facility indicated that it observed a 46% increase in the number of school buses written through Facility rates in 2016, while Facility's share of the industry premiums has jumped from about 2% to 3%. Facility indicates that the volume of business is too small to assign a specific cause to the increase.

[31] Board staff notes that, in these changing circumstances, there is potential for higher volatility in experience and that additional risk may warrant a slightly higher ROE. Board staff recommends, and the Board approves, the proposed rates changes, as filed.

Rating Algorithm

[32] Facility proposed to change its rating algorithm. The change shows where the Charter Trip Factor, which has been approved and in place for some time, is applied in the premium calculation. The change has no impact on premiums, as the method is currently in use, but was not fully reflected in the published rating algorithm.

[33] This change seems reasonable and Board staff recommended that the Board approve the change to the rating algorithm, as filed. The Board agrees.

Rate Manual Review

[34] Board staff have reviewed the current manual that is posted on the Company website, as well as the list of changes proposed by Facility, and have found no areas where the Company appears to be in violation of the *Regulations*.

IV FINDINGS

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

[36] The Board finds the proposed rates are just and reasonable. The Board also approves the changes to the rating rules as proposed.

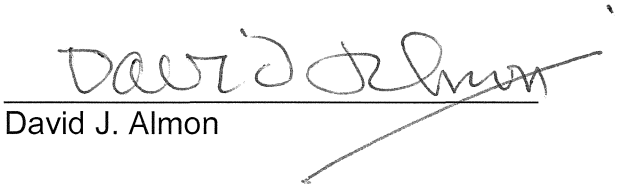
[37] The Application included full actuarial indications; therefore, it qualifies to set the new mandatory filing date for school buses for the Company to March 1, 2020.

[38] The Board approves the effective date for both new business and renewal business at 100 days after the Board's issuance of an Order approving the rates, rounded to the first of the following month.

[39] 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.

[40] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 8th day of June, 2017.



David J. Almon