DECISION

2018 NSUARB 68
M08520

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 for all-terrain vehicles

BEFORE: Peter W. Gurnham Q.C., Chair

APPLICANT: **FACILITY ASSOCIATION**

FINAL SUBMISSIONS: March 27, 2018

DECISION DATE: **April 9, 2018**

DECISION: **Facility is to file revised rates in accordance with the Decision within 15 business days.**

I INTRODUCTION

[1] Facility Association (Facility), filed supporting documents and material (Application) with the Nova Scotia Utility and Review Board (Board) for approval to modify its rates for all-terrain vehicles. The Application was received February 1, 2018.

[2] Information Requests (IRs) were sent to Facility on February 22 and March 7, 2018, and responses were received on March 2 and March 9, 2018 respectively.

[3] As a result of a review by Board staff, a staff report dated March 14, 2018 (Staff Report), was prepared and provided to Facility for review. Facility responded on March 27, 2018, reiterating evidence in the Application. In the circumstances, Board staff did not provide a formal response to the 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 are just and reasonable and in compliance with the *Insurance Act* (*Act*) and its *Regulations*.

III ANALYSIS

[6] Facility sought approval to change the rates for all-terrain vehicles. The Application was made in accordance with the Board's *Rate Filing Requirements for Automobile Insurance – Section 155G Prior Approval* (*Rate Filing Requirements*).

[7] Facility had a mandatory filing date of March 1, 2019. The Application included full actuarial indications and thus meets the requirements of the *Mandatory Filing*

of Automobile Insurance Regulations. Board staff recommended the mandatory filing deadline for these vehicles be reset to February 1, 2021.

[8] The proposed effective dates for Facility for new business and for renewal business is 100 days after the issuance of an Order approving resubmitted rates, rounded to the first day of the following month, for renewals and new business.

Rate Level Changes

[9] Facility proposed changes to its rates for all-terrain vehicles which would result in an average increase of 10.5%. Facility selected rate changes that precisely matched its indications.

[10] Board staff examined 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 filing, the issues that arose concerning the Facility analysis of its rate level needs that warrant further investigation were: (a) return on investment, (b) the profit provision, (c) loss trends, (d) finance fee revenue, and (e) a complement of credibility. Any other concerns that were raised in the IRs were resolved satisfactorily.

Return on Investment

[12] For its return on investment, Facility used 1.11%, based upon current market yields for risk-free government bonds. The use of the risk-free rate was the subject of discussion and findings in the Decision following a public hearing the Board held for Facility for its taxis and private passenger vehicles [2017 NSUARB 172] (Public Hearing).

[13] Facility explained that it does not hold assets for investment. These are held, instead, by its member companies. Facility argued those companies bear the investment risk to achieve higher returns and, therefore, any reward of that higher risk should attach to the companies and not the insured parties. Facility also stated that if it were forced to use a higher rate for return on investment, it should also be allowed to reflect the additional capital associated with the riskier assets that member companies would have to use to generate higher returns. Facility believed, therefore, that a risk-free rate is the appropriate return on investment to employ in the indications.

[14] During the Public Hearing, Oliver Wyman (OW), the Board consulting actuaries, suggested that the industry average return on investment was between 2.5% to 3% return. This return was earned on a basket of assets that would include risk-free assets and others with varying degrees of risk. OW also noted that most member companies would use the same 2:1 premium-to-surplus ratio that Facility uses. This ratio would already reflect, therefore, the riskier asset mix. As such, no additional adjustment was necessary to reflect extra capital.

[15] The Board, in its Decision on the applications in the Public Hearing, determined that the use of the risk-free approach was inappropriate and required Facility

to use 2.5% for its return on investment. The use of this level would result in lower indicated changes.

[16] Consistent with its Decision from the Public Hearing, Board staff recommended the Board require Facility to use 2.5% as its return on investment, instead of the risk-free rate of 1.11%, when developing the indications to be used to assess the reasonableness of the Facility proposal. The Board agrees.

Profit Provision

[17] Facility provided a cost of capital provision using a 12% after-tax return on equity and a 2:1 premium-to-surplus ratio. Using the 1.11% return on investment, the profit provision, expressed as a percentage of premiums, is about 8.1%.

[18] The Board decided in the Public Hearing that 11% is a reasonable return on equity and 2.5% is a reasonable return on investment for Facility. The Board further determined no additional capital above that included in a 2:1 premium-to-surplus ratio was required. Combining the 11% return on equity with the 2.5% return on investment discussed in the last section, the result is a profit provision of 6.7%, and a reduction in indicated rates.

[19] Board staff recommended, consistent with the Decision from the Public Hearing, that the Board require Facility to use a return on equity of 11% and return on investment of 2.5% in its indications. The Board agrees.

Loss Trends

[20] Because all-terrain vehicles lack sufficient experience to develop trends directly, Facility used its private passenger vehicle loss trend selections. This use of private passenger loss trends as a proxy for miscellaneous vehicle trends is common in the industry due to the lack of data.

[21] When industry claims experience data was released by the General Insurance Statistical Agency, Board staff asked OW to develop its selections for loss trends for private passenger vehicles. At the time of the filing, Facility had access to the OW report based on data through December 2016. Subsequently, OW provided a draft of its report based on data through June 2017.

[22] In developing its selections, OW reviewed trends for frequency, severity and loss costs. OW selected trends after examining both 5 and 10 years of data. After selecting past loss cost trends, OW selected future trends to match the selections for past trends.

[23] Facility selected loss trends that differ from those selected by OW. Facility based their selected loss trend rates primarily on a review of industry experience in Nova Scotia through December 31, 2016. Facility reviewed loss experience excluding Allocated Loss Adjustment Expense (ALAE) from 1997-2016 to develop its "indemnity only" loss cost trend selections. The timeframe is longer than that used by OW. As Facility admitted at the Public Hearing, the differences between the use of "indemnity only" data versus "indemnity plus ALAE" data is likely small.

[24] 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.

[25] Staff prepared, for review by the Board, tables comparing the Facility loss trends to the OW selections.

[26] Board staff then compared the Facility indications with those calculated using the December 2016 OW loss trend selections as well as the draft June 2017 OW selections. The OW selections produced higher indicated changes for all but Accident Benefits under both OW reports. Board staff advised that the Facility assumptions in most cases were close to the OW selections. Board staff concluded that the Facility trends are appropriate and recommended the Board allow Facility to use its own selected loss trends or loss model. The Board agrees.

Finance Fee Revenue

[27] Of the three servicing carriers, only Co-operators and Royal Sun Alliance (RSA) provide premium financing for all-terrain vehicles. Co-operators does not charge a premium financing fee. RSA charges a 6% premium financing fee. Facility estimates that after reflecting the mix of business, the overall premium financing fee is less than 0.1%.

[28] The Board outlined its reasons for requiring an adjustment to expenses to recognize premium financing fees and the methodology for determining the adjustment in the Decision from the Public Hearing. While that logic continues to apply, the magnitude of the fees for these vehicles does not warrant making the adjustment in the circumstances of this Application.

Complement of Credibility

[29] Because its data is not fully credible, Facility uses a complement of credibility. In this case, Facility selected, as noted in the Application, "the estimated credibility weighted projected nominal indemnity loss ratio from prior analysis adjusted by the rate change approved by the regulator and projected forward to the future policy period via premium and claims trends (projecting forward the loss ratio from the prior filing)."

[30] The Board has approved a complement for other companies and for Facility in other applications. Where the Board, in the previous all-terrain vehicles Decision, required Facility to use different assumptions than Facility selected to determine indicated changes, the Board expects the complement in this Application will reflect the Board approved indications and not the previous Facility indications.

[31] In the Public Hearing, Facility confirmed that it uses its own assumptions in the complement and acknowledges that the Board may wish to, likewise, use a complement consistent with its view. In its Public Hearing Decision, the Board explicitly stated:

> [181] The Board acknowledges that, for its own analysis purposes, Facility will likely produce indications with a complement that reflects rate inadequacy under its assumption set. The Board, however, requires that, in future filings, Facility use a complement of credibility that reflects rate inadequacy as measured against the Board-approved indications, and only that complement be included in the application.

The Board, therefore, determined that its assumptions must be used in such a complement.

[32] The use of the Board assumptions instead of the Facility assumptions in the complement of credibility would reduce the overall indicated rate increase from 10.5% to 5.2%.

[33] Board staff recommended the Board require the use of the complement of credibility based upon the Board approved assumptions in the previous all-terrain vehicle Decision. This recommendation is consistent with the Decision on this issue in the Public Hearing. The Board agrees.

Staff Indications

[34] Staff Indications are calculated using all Facility assumptions except a return on investment of 2.5%, a return on equity of 11%, and a complement of credibility based on the Board approved assumptions from the previous all-terrain vehicle Decision. This is the target against which to assess the appropriateness of the Facility proposal.

[35] The following table compares the Facility proposed changes with the Staff indicated changes.

	BI, PD & DCPD	AB	UA	SEF#44	Coll	Comp	SP	Total
FA	+17.0%	+25.3%	+101.7%	+21.9%	+18.3%	+10.9%	-35.6%	+10.5%
Staff	+3.9%	+8.2%	+89.9%	-11.5%	+12.0%	+1.4%	-26.3%	+0.0%
Diff.	-13.1%	-17.1%	-11.8%	-33.4%	-6.3%	-9.5%	-2.4%	-10.5%

[36] The next step for the Board is to determine, based upon the Staff Indications, whether the proposed rate changes are reasonable and appropriate. The proposed rates are higher than those suggested by the Staff Indications and produce a return on equity that Facility estimated at 21.5%. This level exceeds the 11% assumption in the Staff Indications and the Board's range of 10% - 12%.

[37] In the circumstances, Board staff recommended the Board not approve the proposed rates, but rather require Facility to submit new proposed rates that follow the Staff Indications and, based on the Staff assumptions, deliver a proposed return on equity of no more than 11%.

[38] The Board agrees and directs Facility to file these revised rates within 15 business days from the issuance of this Decision.

Other Changes

Territorial Differential

[39] Facility does not rate these vehicles by territory. No territorial analysis was provided nor was one required.

Automobile Insurance Manual Review

[40] Staff reviewed the current on-line manual and found no instances where Facility is in violation of the *Regulations*.

IV FINDINGS

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

[42] Facility is not an insurance company but rather is backstopped by its member insurance companies who do business in Nova Scotia. Accordingly, Facility did not provide any financial information. However, recent examination of the mandatory filings of these member companies confirm that it is unlikely that the changes proposed

by Facility, or the changes being made in this Decision, will jeopardize the solvency or well-being of the Facility member companies.

[43] The Board directs Facility to file revised rates as directed in this Decision within 15 business days of the issuance of this Decision.

[44] The Application included full actuarial indications and the required territorial analysis; therefore, qualifies to set the new mandatory filing date for all-terrain vehicles for Facility to February 1, 2021.

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

[46] Facility is required to file an electronic version of its updated Automobile Insurance Manual within 30 days of the issuance of the Order in this matter.

[47] An Order will issue following submission and approval of the revised rates.

DATED at Halifax, Nova Scotia, this 9th day of April, 2018.

Peter W. Gurnham