DECISION **2018 NSUARB 76**
M08544

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 Public Vehicles – School Buses

BEFORE: Roberta J. Clarke, Q.C., Member

APPLICANT: **FACILITY ASSOCIATION**

FINAL SUBMISSIONS: April 4, 2018

DECISION DATE: **April 16, 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 Public Vehicles – School Buses. The Application was received electronically on February 9, 2018, and the hard copy was received on February 13, 2018.

[2] Information Requests (IRs) were sent to Facility on February 26 and March 16, 2018, and responses were received on March 6 and March 20, 2018, respectively.

[3] As a result of a review by Board staff, a staff report dated March 23, 2018 (Staff Report), was prepared and provided to Facility for review. Facility responded on April 14, 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 Public Vehicles – 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] Facility had a mandatory filing date of February 1, 2020. 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 proposed 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 Public Vehicles – School Buses which would result in an average increase of 16.1%. Facility selected rate changes that matched its indications exactly.

[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 (ROE).

[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: return on investment; the profit provision; and, loss trends. 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's 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 ROE 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 ROE 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% ROE with the 2.5% return on investment discussed in the previous section, results in 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 an ROE of 11% and return on investment of 2.5% in its indications. The Board agrees.

Loss Trends

[20] When industry claims experience data was released by the General Insurance Statistical Agency through December 2016, Board staff asked OW to develop its selections for loss trends for commercial vehicles.

[21] In developing its selections, OW reviewed trends for frequency, severity and loss costs. OW selected trends after examining both 15 and 10 years of data. After selecting past loss cost trends, OW selected future trends to match the selections for past trends.

[22] 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 1996-2016 to develop its "indemnity only" loss cost trend selections. The timeframe is longer than that used by OW. As Facility acknowledged at the Public Hearing, the differences between the use of "indemnity only" data versus "indemnity plus ALAE" data is likely small.

[23] The loss trends used by Facility in this Application are very close to those used in the Taxi Public Hearing.

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

[25] Board staff then compared the Facility indications with those calculated using the December 2016 OW loss trend selections.

[26] In the Public Hearing, OW compared the Facility loss trends to their own, eventually determining that the only concerns related to Bodily Injury, Property Damage-Tort, and Direct Compensation Property Damage loss trends. Board staff used the OW loss trends used in the Public Hearing in reviewing this Application.

[27] In the Board's decision on Taxis [2017 NSUARB 172], the Board required Facility to replace its selections for Bodily Injury, Property Damage-Tort and Direct

Compensation Property Damage with 0%. The selections made by Facility in this Application and those it made in that application are very close, and the OW selections are the same; therefore, Board staff recommended the use of the Board approved loss trends from the Taxi application in this Application to develop indications by which the reasonableness of the proposed changes are to be assessed. The Board accepts this recommendation.

[28] In response to a request from Board staff, Facility provided indications using the revised trends. This resulted in a lower overall increase of 12.8%.

Finance Fee Revenue

[29] Of Facility's three servicing carriers, only Co-operators provides premium financing for Public Vehicles – School Buses. Co-operators does not charge a premium financing fee.

[30] As a result, unlike other categories of vehicles insured by Facility as discussed in other recent Board decisions (for example, M08520 – All Terrain Vehicles), there is no need to make any adjustments to expenses in the circumstances of this Application.

Staff Indications

[31] Staff Indications are calculated using all Facility assumptions except a 0% loss trend for Bodily Injury, Property Damage-Tort, and Direct Compensation Property Damage coverages, a return on investment of 2.5%, and an ROE of 11%. This is the target against which to assess the appropriateness of the Facility proposal.

[32] The Board must 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 an ROE that Facility estimated at 18%. This level exceeds the 11% assumption in the Staff Indications and the Board's range of 10% - 12%.

[33] 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 ROE of no more than 11%.

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

Other Changes

[35] Facility proposed several changes to its rating or underwriting rules, mainly to clarify current rules for Manual users. These changes do not change processes, and no changes in premiums arise from them.

[36] Facility proposed one change which will have an impact on premiums for newly acquired vehicles. A change to Rule 300.B.3 - Filed Underwriting Rules will result in a different process for the calculation of the Direct Compensation Property Damage coverage premium where a vehicle, licensed for highway or road use, is used as well for race or speed tests. Instead of basing the rate on a required current appraisal of the vehicle, the rate will be based on the rate group as determined under Rule 301 Vehicle Rate Group.

[37] Board staff recommended that the rule changes be approved, and the Board accepts that recommendation.

Automobile Insurance Manual Review

[38] Board staff reviewed the current on-line Manual and found no instances where Facility is in violation of the *Regulations*.

IV FINDINGS

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

[40] Facility is not an insurance company but rather is supported 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.

[41] The Board finds that rates revised in accordance with the directions in Paragraph [33] are just and reasonable and directs Facility to file revised rates as directed in this Decision within 15 business days of the issuance of this Decision.

[42] The Application included full actuarial indications; therefore, it qualifies to set the new mandatory filing date for Public Vehicles – School Buses for Facility to February 1, 2021.

[43] 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.

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

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

DATED at Halifax, Nova Scotia, this 16th day of April, 2018.

Roberta J. Clarke