

**DECISION**

**2019 NSUARB 10  
M08978 and M08979**

**NOVA SCOTIA UTILITY AND REVIEW BOARD**



**IN THE MATTER OF THE INSURANCE ACT**

**- and -**

**IN THE MATTER OF APPLICATIONS** by **FACILITY ASSOCIATION** for approval to modify its rates for motorcycles and all-terrain vehicles

**BEFORE:** Stephen McGrath, LL.B., Member

**APPLICANT:** **FACILITY ASSOCIATION**

**FINAL SUBMISSIONS:** January 15, 2019

**DECISION DATE:** **January 22, 2019**

**DECISION:** **Applications are approved.**

## I INTRODUCTION

[1] Facility Association (Facility) filed supporting documents and materials (Applications) with the Nova Scotia Utility and Review Board (Board) for approval to modify its rates for motorcycles (M08978) and all-terrain vehicles (ATVs) (M08979). The Applications were dated November 16, 2018 and filed electronically on that day.

[2] Information Requests (IRs) in both Applications were sent to Facility on December 13, 2018, and responses were received on December 18, 2018. Additional IRs were issued in M08979 on December 19, 2018, to which Facility responded on December 20, 2018. Additional IRs were issued in M08978 on December 21, 2018, to which Facility responded that same day.

[3] As a result of a review by Board staff, a staff report dated January 4, 2019 (Staff Report) was prepared and provided to Facility on that day for review. Facility responded on January 15, 2019, essentially reiterating evidence in the Applications. 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 Applications.

## II ISSUE

[5] The issue in these Applications 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 its rates for motorcycles and ATVs. The Applications were made in accordance with the Board's *Rate Filing Requirements for Automobile Insurance – Section 155G Prior Approval (Rate Filing Requirements)*. Facility's mandatory filing date for both motorcycles and ATVs was February 1, 2021.

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

#### **Rate Level Changes**

[8] In the Applications, Facility presented indications for rate increases based on a target post-tax return on equity (ROE) of 12%, and Facility's assumptions for the loss trends and investment returns (Facility Indications). Facility advised that the targeted 12% ROE was set by its Board of Directors to be used in general for Facility rate applications.

[9] The Applications also included alternative indications, selected by Facility management and approved by its Board of Directors (Alternative Indications). The Alternative Indications reflect management's interpretation of what the Board requires based on past decisions where the Board directed the use of an 11% ROE and a projected loss ratio using assumptions accepted by the Board to set rates as the complement of credibility.

[10] Facility's proposed changes to rates in the Applications are the same as the Alternative Indications and represent overall rate level increases of 16.1% for motorcycles and 10.0% for ATVs.

[11] In considering Facility's Applications, Board staff reviewed all aspects of the ratemaking procedure, including the following:

- Loss trends;
- Impacts of 2010 Minor Injury Reform;
- Loss development;
- Unallocated loss adjustment expense provisions;
- Credibility standards and procedure;
- Expense provisions;
- Experience period and weights;
- Premium to surplus ratio; and
- Target ROE.

[12] Based on Board staff's review of the filing, the issues that arose concerning the Facility analysis of its rate level needs that warranted further investigation in both Applications were: (a) return on investment (ROI), (b) the selected loss trends, (c) the health services levy, and (d) finance fee revenue. Any other concerns that were raised in the IRs were resolved satisfactorily.

### **Return on Investment**

[13] For its ROI in both Applications, Facility used 1.89% based upon current market yields for risk-free government bonds. Facility explained that it does not hold assets for investment. These are held, instead, by its member companies.

[14] 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

ROI, 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 believes, therefore, that a risk-free rate is the appropriate ROI to employ in its indications.

[15] 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 taxi and private passenger vehicles applications in September 2017 [2017 NSUARB 172] (Public Hearing).

[16] During the Public Hearing, Oliver Wyman (OW), the Board consulting actuaries, suggested that the industry average ROI was between 2.5% to 3%. 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 of Facility's member companies 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.

[17] 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 ROI. The use of this level would result in lower indicated changes.

[18] Consistent with the Decision from the Public Hearing, Board staff recommended the Board require Facility to use 2.5% as its ROI, instead of the risk-free rate of 1.89%, when developing the indications to be used to assess the reasonableness of the Facility proposal in the Applications. Board staff noted that, in a more recent Facility application for rates for taxis and private passenger vehicles in November 2018, OW suggested that the industry average ROI was higher now than it was in September 2017.

Because the Board has not rendered a decision in that proceeding, Board staff recommended that the Board require Facility to use the lower rate accepted by the Board in the Decision from the Public Hearing. The Board agrees with this recommendation.

### **Loss Trends**

[19] Because miscellaneous vehicles lack enough experience to develop trends directly, Facility used its private passenger vehicle loss trend selections. The use of private passenger loss trends as a proxy for miscellaneous vehicle trends is common in the industry due to the lack of data.

[20] Facility based its selected loss trend rates primarily on a review of industry experience in Nova Scotia through December 31, 2017.

[21] The Board periodically publishes loss trend selection reports prepared by OW. These are based on industry wide Nova Scotia data and are made available on the Board's website. These loss trend selections are considered by the Board to be benchmarks and may be used by insurance companies to determine indicated rates. Without evidence to the contrary, the Board views these loss trend selections as the appropriate ones for use in generating indicated rate level need.

[22] When a company chooses to use loss trend selections that are different than the benchmarks, it must provide a detailed discussion of the methodology used to provide loss trends in its rate application. The company must also compare its loss trends to the benchmark trends and provide a justification for significant differences in the trends.

[23] In developing its selections, OW reviewed trends for frequency, severity and loss costs. After selecting past loss cost trends, OW selected future trends to match the selections for past trends.

[24] Facility selected loss trends that differ from those selected by OW. Staff prepared, for review by the Board, tables comparing the Facility loss trends to the OW selections. Board staff commented that the loss trend selections were close in both Applications. Board staff then compared the Facility Indications with those calculated using the December 2017 OW loss trend selections (noting that the general conclusions from this comparison could be inferred for the Alternate Indications).

[25] The OW selections produced indicated changes that varied from the Facility Indications within +/-2% for all coverages except S.E.F. #44 and Specified Perils in both Applications, and Uninsured Auto in the case of ATVs. In all of these instances, the OW selections produced higher indicated changes than in the Facility Indications. Overall, the indicated changes using the OW selections were close, but slightly higher using the OW selections.

[26] Board staff concluded that the Facility trends are appropriate and recommended that the Board allow Facility to use its own selected loss trends or loss model in these Applications. The Board agrees.

### **Health Services Levy**

[27] Motorcycles and ATVs attract the Province's health services levy, and Facility reflects this levy in its indications. Facility included the levy at its 2017 level of \$33.09.

[28] The 2018 levy, which Facility indicated in its IR responses was not available when its indications were completed, is \$36.38. Board staff recommended that Facility should reflect the latest value for the levy in its indications. Board staff noted that, had Facility done so, its indications would be about 1.0% higher overall for motorcycles and 1.8% higher overall for ATVs, reflecting a 3.8% increase in indications for: Bodily Injury, Property Damage - Tort, and Direct Compensation Property Damage. Facility agreed with this recommendation in its response to the Staff Report.

[29] The Board accepts the recommendation that the higher health services levy should be used by Facility in determining its indicated changes.

### **Finance Fee Revenue**

[30] In the Decision from the Public Hearing, the Board outlined reasons for requiring an adjustment to Facility's expenses to recognize premium financing fees and the methodology for determining the adjustment. This was also an issue in the more recent Facility application for rates for taxis and private passenger vehicles in November 2018, but as noted above, a decision has not yet been rendered in that matter. In the present Applications, the Board finds that an adjustment to offset expenses is not required in any event.

[31] In the case of motorcycles, of Facility's three servicing carriers, only Co-operators Insurance (Co-operators) provides premium financing for motorcycles. Because Co-operators does not charge a premium financing fee, there is no revenue to use to offset expenses.

[32] In the case of ATVs, 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 its mix of business, the overall premium financing fee is less than 0.1%, which the Board finds would not warrant an adjustment, given the magnitude of the fees for ATVs.

### **Staff Indications**

[33] Staff Indications are calculated using all Facility assumptions used to produce the Alternate Indications except the use of an ROI of 2.5% and the higher health services levy. This is the target against which to assess the appropriateness of the Facility proposal.

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

[35] For motorcycles, the overall proposed rate change is slightly higher than using the Staff indications. This result produces an ROE of 11.9%. While this is higher than the 11% assumption in the Staff Indications, it is below the 12% upper end of the Board range. Board staff advises that forcing Facility to lower its rates to provide an 11% ROE would result in a \$5.00 decrease on average and submits that while there are differences, both overall and by coverage, the differences are not large enough to warrant requiring Facility to make a change. Board staff recommend that the Board approve the proposed rate changes for motorcycles, as filed.

[36] For ATVs, the overall proposed rate change matches the overall change produced using the Staff indications and produces an ROE of 11% that matches the

assumption used to produce the Staff indications. Although there are some differences by coverage, Board staff recommend that the Board approve the proposed rate changes for ATVs, as filed.

[37] The Board agrees with Board staff recommendations to approve the rate changes proposed for motorcycles and ATVs.

### **Other Changes**

#### *Territorial Differential*

[38] Facility does not rate these vehicles by territory.

### **Automobile Insurance Manual Review**

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

## **IV FINDINGS**

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

[41] 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 will jeopardize the solvency or well-being of the Facility member companies.

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

[43] The Applications included full actuarial indications; therefore, they qualify to set the new mandatory filing date for motorcycles and ATVs for Facility to November 1, 2021.

[44] The Board approves the effective date of 100 days after the Board's issuance of the Order in this matter, rounded to the first day of the following month, for new business and renewal business.

[45] 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.

[46] An Order will issue accordingly.

**DATED** at Halifax, Nova Scotia, this 22<sup>nd</sup> day of January, 2019.

  
Stephen T. McGrath