DECISION **2018 NSUARB 229**
M08982

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE INSURANCE ACT

- and -

IN THE MATTER OF AN APPLICATION by **LLOYD'S UNDERWRITERS** for approval to modify its rates for miscellaneous vehicles

BEFORE: Richard J. Melanson, LL.B., Member

APPLICANT: **Lloyd's Underwriters**

FINAL SUBMISSIONS: December 12, 2018

DECISION DATE: **December 21, 2018**

DECISION: **Application is approved.**

I INTRODUCTION

[1] Lloyd's Underwriters (Lloyd's or Company) filed supporting documents and materials (Application) with the Nova Scotia Utility and Review Board (Board) for approval to modify its rates for miscellaneous vehicles (motorcycles, all-terrain vehicles, snow vehicles and trailers). The Application was dated November 21, 2018 and filed on November 22, 2018.

[2] Information Requests (IRs) were sent to Lloyd's on November 29, 2018, and responses were received on December 4, 2018.

[3] As a result of review by Board staff, a staff report dated December 10, 2018 (Staff Report), was prepared. The Staff Report was provided to the Company for review on the same day. The Company responded on the same day, indicating that it had reviewed the Staff Report, and except for three minor errors, the report was thorough and objective. The minor errors were corrected in the report that was provided to the Board for review.

[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] The Company sought approval to modify its rates for miscellaneous vehicles. 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 August 1, 2019.

[7] The proposed effective date is March 1, 2019, for new and renewal business.

[8] Lloyd's proposed changes to its base rates that are uniform by territory, but vary by coverage and vehicle type.

[9] Lloyd's proposed no changes to the base rates for motorcycles, despite indications showing a need for small increases. Lloyd's proposed the following changes to base rates for all terrain vehicles (ATV's) and snow vehicles, which in both cases were higher than indicated changes.

- ATVs +42.3%
- Snow vehicles +35.8%

[10] Lloyd's proposed substantial increases to Comprehensive and All Perils base rates for ATVs and snow vehicles, while maintaining the base rate for all other coverages.

[11] Lloyd's also proposed the introduction of a stand-alone charge for the Health Services Levy for all vehicle types, as well as a change to its Business Use Surcharge.

[12] Board staff reviewed the rate level indications developed by the Company and in doing so examined all aspects of the ratemaking procedure including:

- Loss trends;
- 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 and complement of credibility;
- Premium to surplus leverage ratio; and
- Target and proposed Return on Equity (ROE).

[13] Based on staff's review of the filing, the only issue that arose surrounding the Company's analysis of its rate level that warrants some discussion was loss trends. Any other issues raised were successfully resolved in the IR process.

Loss Trends

[14] The Company based its selected loss trends primarily on a review of industry experience in Nova Scotia through December 31, 2017. The Company examined experience from 1998 through 2017 but focused primarily on data from 2008-2017 for most coverages. The actual years used (start point, end point and excluded years) to determine trend selections varied by coverage.

[15] The Company used an exponential regression analysis to develop the trend selections and applied judgement to determine which model provided the best fit or best explained the observed data. The analysis was performed on annual data and examined loss cost only due to concerns about claims count referenced in the notes to the General Insurance Statistical Agency (GISA) exhibits Lloyd's used for the analysis. In those cases where the model failed to produce a result, Lloyd's used actuarial judgment to make its selection.

[16] The data was adjusted to reflect the various reforms that took place during the observation period (e.g., 2003 minor injury cap introduction, 2010 minor injury cap reform and 2012 accident benefit reform, 2013 introduction of DCPD).

[17] With the release of the industry claims experience data through December 2017, Board staff requested Oliver Wyman (OW), the Board's consulting actuaries, to develop assumptions for loss trends for private passenger vehicles. OW examined trends for frequency, severity and loss cost information, and made its selections after examining both 5 and 10 years of data, on a half-yearly basis.

[18] For future trends, OW selected the past trend assuming it would continue. For all coverages except DCPD, Lloyd's also set future trends equal to past trends.

[19] Board staff compared the Company and OW trends, and the indications derived from Lloyd's use of the OW trends.

[20] Based on the closeness of the trends and the overall change, Board staff recommends the Board allow Lloyd's to use its own selected loss trends in developing the indications to be used to assess the appropriateness of the Lloyd's proposal. The Board agrees with this recommendation.

[21] The targets against which the Lloyd's proposal should be assessed for reasonableness, therefore, are the Lloyd's indications as filed.

Motorcycles

[22] Despite the indicated need for small increases, Lloyd's proposed no changes to rates for these vehicles. Lloyd's did propose the introduction of a separate charge for the Health Services Levy. Based on the 2017 levy amount of $33.06, Lloyd's proposed a charge of $33.00.

[23] When informed the 2018 levy was $36.38 in the IR process, Lloyd's changed the proposed stand-alone charge to $36.00. As a result, all motorcycles will see a premium increase of $36.00, representing an average overall change of about 14%.

[24] The proposal results in a ROE of 7.2%, which falls below the Company target and the low end of the Board's range of 10-12%.

[25] Board staff recommends the Board approve the proposal for no change to the current rates for motorcycles and the proposed addition of the $36.00 stand-alone charge for the Health Services Levy, as revised. The Board agrees.

Snow Vehicles

[26] Lloyd's only proposed changes to base rates for Comprehensive and All Perils coverages, as it strives to address concerns with these coverages. The proposed All Perils change of 3% is close to the indicated increase.

[27] The proposed change for Comprehensive was 120%, compared to an indicated change of 18.5%. To put some perspective on the change, the average Comprehensive premium will grow by about $94.00 under the proposal, while the indicated increase is about $15.00. The Company explained that given poor loss ratios over the past five years (more than 100%), the change is needed to keep snow vehicles insurance viable in Nova Scotia.

[28] Lloyd's provided a comparison of its average written premium to that of the industry. While the average premium over the three-year period provided suggests Lloyd's may be underpriced relative to the industry, the 2017 comparison shows the difference is much less for Comprehensive. The indicated increase for Comprehensive would bring the two in line. The All Perils average written premium for 2017 exceeds the industry value. Based on this observation, Board staff asked the Company to explain how the proposal was supported.

[29] The Company responded:

> The purpose for including Exhibit C.7 for both ATV and SV, was twofold. First, to show that the Comprehensive premiums for Lloyd's are still much lower than Industry, even after the most recent rate change in 2016. Second, to demonstrate that Lloyd's market share is very high for Physical Damage coverages compared to their market share for mandatory coverages. Such disparities may be a sign of adverse selection.
>
> However, what these exhibits do not show is a comparison of the Lloyd's and Industry loss costs and loss ratios. This should have been provided in the filing in order to reveal a comprehensive picture of the current situation.
>
> From the GISA exhibits labelled "Response 5" attached, we see that the Lloyd's ATV Comprehensive and All Perils and SV Comprehensive loss costs and loss ratios (which are undeveloped and exclude ULAE) are much higher than the corresponding Industry loss costs and loss ratios (which include development and a provision for ULAE). Although Lloyd's average premiums may be more in line with the Industry's, the attached information clearly shows that Lloyd's loss experience is much worse than the Industry's.
>
> It is the underwriters' belief that the initial Nova Scotia rates (i.e., when the program was first introduced in the province) were much too low compared to the Lloyd's rates in other jurisdictions. Ever since there has been sufficient Lloyd's experience in Nova Scotia to derive actuarial indications, Lloyd's has had to propose large average rate level changes in order to address the inadequacy of the initial rates and the poor results. Adopting large Physical Damage average rate level changes is the only way of making the program viable for the underwriters on a go forward basis in order for them to be able to continue to provide coverage for the customers of Nova Scotia.
>
> [Response to question 5 of IR-1]

[30] The additional exhibits show the loss ratios for Lloyd's are higher than industry and support the need for an increase.

[31] Despite the poor experience, the claims count does not result in the Lloyd's experience being fully credible. In fact, Lloyd's data has very little credibility. This result forces the selected complement of credibility (i.e., one year of net trend) to be the driving force for the indicated increase. Lloyd's argues this does not address its poor experience quickly enough and may lead to adverse selection (poorer risks seeking the lower, inadequate rates with Lloyd's) that could worsen the situation. The actuary completing the Application argued:

> By proposing average rate level changes that rely more heavily on the actual experience, I am giving less weight to the complement of credibility than what is being used in the indications. The reason for relying more heavily on the experience is that it

> is consistently bad throughout the experience period. This is very different from a situation in which there is low credibility combined with highly volatile results.
>
> I believe Lloyd's is in a unique situation in which rates were initially set an at [*sic*] inadequate level when the program was first introduced in Nova Scotia. This became obvious a while back but there wasn't sufficient experience to derive actuarial indications to address the issue. I believe it would have been even harder to justify a large rate change based on indications using only two or three years of data. Although the time elapsed has proven that rates are still inadequate, the delay has contributed to additional losses for the underwriters.
>
> Given the low credibility (in terms of number of claim counts) assigned to the experience, it would take too much time to address the rate inadequacies if Lloyd's were strictly limited to adopting the actuarial indications.
>
> [Response to question 7 of IR-1]

[32] Lloyd's explains that a larger percentage of its insured snow vehicles (over 60%) than the industry snow vehicles (about 35%) carry Comprehensive. While these vehicles will see the larger than indicated increase in Comprehensive premiums, they will also benefit from the decision to forego the indicated increases for mandatory coverages. This will, however, only provide a small offset to the Comprehensive increase.

[33] Given the overall proposed increase exceeds the indicated increase, the ROE that arises from the proposal (25.8%) is well above the top end of the Board's range of reasonableness. However, the circumstances surrounding this case warrant, in Board staff's opinion, the increase to Comprehensive that produces this result.

[34] It is clear that Lloyd's needs an increase. The Board accepts that the indicated increase may not address the concerns about inadequate rates and poor experience. Any compromise measure, such as allowing half of the proposed increase, will only delay the inevitable increase.

[35] By allowing the full change, the clients may have to shop around to see if they can achieve a better rate, and any adverse selection that brings clients to Lloyd's, based on being underpriced for these coverages, may be mitigated.

[36] Lloyd's will also introduce the $36.00 stand-alone charge for the Health Services Levy, for these vehicles.

[37] After a detailed analysis, Board staff recommends the Board approve the proposed changes to the base rates for snow vehicles and the proposed addition of the $36.00 stand-alone charge for the Health Services Levy, as revised. The Board is satisfied with this analysis and approves the changes.

All Terrain Vehicles

[38] These vehicles represent the largest number of the three types of vehicles included in this Application.

[39] As with snow vehicles, Lloyd's proposed no changes to any coverage other than Comprehensive and All Perils. For ATVs, the proposed changes are much larger than the indicated changes for both coverages.

[40] The rationale for the much higher proposed changes than indicated is the same for these vehicles as for snow vehicles.

[41] The loss ratios for these coverages are much higher for Lloyd's than for the industry. For All Perils, Lloyd's contributed almost half the claims in the industry. For Comprehensive, the Lloyd's claims are about 25% of the industry claim count. This suggests the industry experience, excluding Lloyd's, would be even better than the Lloyd's only experience.

[42] Clients with these two coverages will see some very large increases. The All Perils average premium will increase by about $200.00, and the Comprehensive average premium will increase by about $100.00.

[43] Given the overall proposed increase exceeds the indicated increase, the ROE that arises from the proposal (21.7%) is well above the top end of the Board's range of reasonableness. However, the circumstances surrounding this case warrant, in Board staff's opinion, the increases to Comprehensive and All Perils that produce this result. The Board agrees.

[44] Lloyd's will also introduce the $36.00 stand-alone charge for the Health Services Levy.

[45] Despite the large potential increases, and the high ROE, Board staff recommends the Board approve the proposed changes to the base rates for ATVs and the proposed addition of the $36.00 stand-alone charge for the Health Services Levy, as revised.

[46] The Board has considered the evidence provided by Lloyd's, and the comprehensive analysis provided by Board staff. The Board agrees with Board staff's recommendation.

Business Use Surcharge

[47] When a client uses one of these vehicles for business or commercial purposes, Lloyd's applies a 25% surcharge. The Company proposed to increase this surcharge to 35%.

[48] Lloyd's stated the changes were based upon a review of British Columbia and Saskatchewan business use polices. In these Provinces, Lloyd's charges a surcharge based upon the number of kilometers driven. The average surcharge for the business use vehicles was 39.62%.

[49] In the last application, Lloyd's increased the surcharge from 10% to 25%. As justification, Lloyd's stated that the "…average Business Use Surcharge based on its current portfolio in other Canadian provinces (excluding Nova Scotia) is 38.5%, which is well above what is being currently charged in Nova Scotia." At that time, the same situation as the current one existed in other jurisdictions, but Lloyd's opted for only a 25% surcharge in Nova Scotia. The Company explained that it chose, at that time, to temper the impact of the surcharge. Lloyd's believes it is now time to move to the theoretical level.

[50] Lloyd's has very few business use policies that cover an extremely small portion of the vehicles the Company writes. Despite the low demand, Lloyd's wants to continue its attempt to address all its clients' needs by offering the business use option. The surcharge provides compensation for the additional risk.

[51] Board staff recommends the Board approve the proposed increase in the Business Use Surcharge, as filed. The Board accepts this recommendation.

Automobile Insurance Manual Review

[52] In addition to the changes required to implement the proposed increase to the Business Use Surcharge, Lloyd's proposed many changes to the rating rules in the manual. These changes will clarify the existing wording, change some coverage limits, or address areas where referrals for special acceptance will be required, or will not be required anymore. Apart from the Business Use Surcharge change, no other rule changes impact premiums. Board staff recommends the Board approve the proposed changes to rating rules, as filed. The Board concurs with this recommendation.

[53] Board staff reviewed these changes and the manual on file and found no areas where the Company appears to be in violation of the *Regulations.*

Effective Date

[54] Lloyd’s proposed an effective date of March 1, 2019, for new and renewal business. These dates seem reasonable, and Board staff recommends that the Board approve them.

IV FINDINGS

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

[56] 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.

[57] The Board approves the proposed changes to base rates for all vehicles as filed.

[58] The Board approves the proposed introduction of a stand-alone Health Services Levy charge, as revised through the IR process.

[59] The Board approves the proposed changes to the Business Use Surcharge, as filed.

[60] The Board approves the proposed changes to the rating rules, as filed.

[61] The Board approves the effective date of March 1, 2019, for new and renewal business.

[62] Because the Application included full actuarial analysis, it meets the requirements of the *Regulations* to reset the mandatory filing deadline for these vehicles. The mandatory filing deadline is reset to November 1, 2021.

[63] The Company 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.

[64] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 21 day of December, 2018.

Richard J. Melanson