NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES

AN ORDER OF THE BOARD

NO. A.I. 25(2018)

IN THE MATTER OF the *Automobile Insurance Act*, RSNL 1990, c. A-22, (the "*Act*"), as amended and regulations thereunder; and

IN THE MATTER OF an application by Facility Association for approval of revised rates for its Newfoundland and Labrador Public Bus class of business.

1. The Application

Facility Association ("Facility"), as operator of the residual market mechanism for automobile insurance in the Province, filed a Category 2 application on December 11, 2017 seeking approval of increased rates for its Newfoundland and Labrador Public Bus class of business (the "Application"). The Application proposes an overall rate change of +3.6% with rates to be effective no earlier than 100 days post-approval rounded to the 1st of the following month for both New Business and Renewals.

2. Procedural Matters

The Application was referred to the Board's actuarial consultants, Oliver Wyman Limited ("Oliver Wyman"), for review.

On December 28, 2017 Oliver Wyman filed questions on the Application. Facility filed responses on January 10, 2018.

On January 26, 2018 Oliver Wyman filed a report outlining its review of the actuarial justification provided in the Application ("Oliver Wyman's Report"). Facility filed comments in response to Oliver Wyman's Report on February 6, 2018. Oliver Wyman advised it had no follow up commentary on February 7, 2018.

On March 9, 2018 the Board extended the 90-day review timeline.

3. Review of Application Proposals

The Application presented Facility's rate level need using three sets of assumptions for cost of capital and return on investment. Facility proposes an overall rate change of +3.6% based on its indication using 0% cost of capital and 2.80% return on investment as follows:

Coverage	Facility Indication	Facility Proposal
Third Party Liability	+5.9%	+5.9%
Accident Benefits	+5.1%	+5.1%
Uninsured Auto	+3.1%	+3.1%
Collision	-9.0%	-9.0%
Comprehensive	-3.2%	-3.2%
Specified Perils	-5.8%	-5.8%
Total	**+3.6%**	**+3.6%**

Facility estimated the proposed rate change would increase the total average premium from $2,701 to $2,798 or by $97. Facility's last Category 2 rate application for this line of business was submitted to the Board in January 2017, with approval of an overall rate level increase of 10.9% effective February 1, 2018.[1]

Oliver Wyman reviewed Facility's proposals and associated ratemaking procedure and found Facility's underlying assumptions and estimates used in its ratemaking procedures to be generally reasonable with certain exceptions. According to Oliver Wyman substitution of alternate but reasonable assumptions used by Facility would lead to a lower rate level indication than Facility has estimated and proposed. These include Facility's loss trend rates and adjustment for the HST rate change. Oliver Wyman also raised a concern with Facility's treatment of finance fee revenues. These issues, along with the Board's findings on each, are discussed in the following sections.

4. Board Findings

The Board is cognizant that there are a wide range of possible outcomes in any prospective ratemaking exercise. In accordance with the *Automobile Insurance Act* the Board must be satisfied that the proposed rate changes are supported based on the information filed and are not too high in the circumstances. In making this determination the Board looks to the professional judgement of the actuaries as well as the support and explanation for their respective positions.

The Board has reviewed the record, including Facility's Actuarial Memorandum, Oliver Wyman's reports, and Facility's responses to Oliver Wyman's reports and information requests. The Board notes that Oliver Wyman found Facility's underlying assumptions and estimates used in its ratemaking procedures to be generally reasonable with the exception of loss trend rates and HST adjustment. These issues, along with the Board's findings on each, are discussed in the following sections.

[1] See Order Nos. A.I. 10(2017) and A.I. 16(2017).

4.1 Loss Trend Rates

Loss trend rates are applied to the experience period incurred losses to adjust for the cost levels that are anticipated during the policy period covered by the proposed rates. The Board requires that, to the extent feasible, loss trends should be based on Industry NL claim frequency and claim severity data, with claims and losses developed to ultimate. The selection of the appropriate loss trend rate by coverage is a matter of actuarial judgement in the statistical analysis of the underlying data. Oliver Wyman updates the Board Guideline Industry NL loss trend experience every six months[2]. Companies are not required to use the guideline loss trends but full rationale for use of different factors must be provided and supported.

Facility selected past loss cost trend rates for each of the Bodily Injury, Property Damage, Accident Benefits, Uninsured Auto, Collision, and Comprehensive coverages based on its analysis of Industry Commercial Vehicle claim experience as of December 31, 2016. Frequency and severity trend rates were separately determined and then combined to arrive at its selected past loss cost trend rates. Facility's selected future loss trend rates the same as the past trend rates.

Oliver Wyman compared Facility's Commercial Vehicle loss trend rate selections against the Board Guideline loss trend rate selections:

Loss Trend Rate Selections		
	Facility	**Board Guideline**
Bodily Injury	+2.3%	+0.5%
Property Damage	+2.8%	+1.0%
Accident Benefits	0.0%	+8.5%
Uninsured Auto	+10.5%	+8.5%
Collision	0.0%	0.0%
Comprehensive	0.0%	+4.0%
Specified Perils	0.0%	+4.0%

At Oliver Wyman's request Facility estimated its rate level change based on the Board Guideline loss cost trends, and with no other changes in assumptions, would reduce from +3.6% to +2.1%. Oliver Wyman commented on the general differences in the data and approach used by Facility when compared to its approach in updating the Board Guideline loss trends and elaborated on the reasons for the differences between its selected loss trend rates and Facility's selected loss trend rates.

With respect to Bodily Injury loss trend rates Oliver Wyman noted that the difference in selected loss trend rate was due to Facility's higher selected frequency trend rate. Facility determined its frequency trend rate for Bodily Injury coverage based on a regression analysis of its estimate of Industry Commercial Vehicle ultimate claim counts by accident half-year over a 20-year period ending December 31, 2016, split into two time segments.[3] Oliver Wyman noted:

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[2] The Board Guideline loss trend rate selections used in the review of this filing were updated as of December 31, 2016.

[3] The two time periods used were 1997-1 to 2004-1 and 2004-2 to 2016-2.

> FA's view of frequency declining in a "step" (by segment) is in contrast to our view (and that of most other insurers' models we have reviewed for Bodily Injury in NL) that frequency has exhibited more of a steady decline, in particular since 2012 – the beginning of FA's experience period.[4]

Oliver Wyman provided a graph of Bodily Injury claim frequency rates for the most recent 15 years by accident half-year which, in its view, supports the general decline in frequency rate from 2003 to 2016 rather than a segment-by-segment decline as presented by Facility. Oliver Wyman also noted that Facility offered no explanation of the cause of the steep decline in claim frequency level at the start of the second time segment used by Facility. With respect to Facility's assumption that claim frequency will remain level after 2016 through 2022 leading to a selected 0.0% future frequency trend rate, Oliver Wyman stated that there is no evidence to indicate that the decrease in frequency trend rate will not continue through the future projection period. Oliver Wyman found its selected Bodily Injury loss cost frequency trend rate of -2.5% to be supported and reasonable and found Facility's selected frequency trend rate of 0.0% to be too high.

For Property Damage coverage Oliver Wyman found that, over the last three years beginning 2014-1, frequency has shown a clear pattern of decline and that its selected frequency trend rate of -1.5% continued to be supported and reasonable. Facility determined its frequency trend rates for Property Damage based on a regression analysis of its estimate of Industry Commercial Vehicle ultimate claim counts by accident half-year over a 20-year period ending December 31, 2016, split into two segments[5], and selected a 0.0% annual frequency trend rate. Oliver Wyman provided a graph of the Property Damage claim frequency rates and found Facility's selected trend rate of 0.0% to be too high.

For Accident Benefits coverage Oliver Wyman found Facility's selected severity trend rate to be low. Facility determined its severity trend rates based on a regression analysis of its estimate of Industry Commercial Vehicle ultimate average claim cost by accident half-year over the 20-year period ending December 31, 2016, split into two time segments[6]. Oliver Wyman noted that Facility's estimate of the Industry ultimate loss amounts and claim counts was based on the Atlantic Accident Benefits coverage experience whereas Oliver Wyman's estimate was based on total NL Accident Benefits experience. Oliver Wyman also noted the volatility associated with the experience data.

Based on its analysis Facility found that severity during the second segment was 93% higher than the first segment and that the annual severity trend rate continues to be 0.0%. Based on the Accident Benefits claim severity data used in its analysis, Oliver Wyman found its selected severity trend rate of +8.5% to be supported and reasonable and Facility's selected severity trend rate of 0.0% to be too low.

In the case of loss trend rates for Uninsured Auto coverage Oliver Wyman noted the volatility associated with the Uninsured Auto data but found Facility's selected severity trend rate of +10.5% to be too high. Facility determined its severity trend rate for Uninsured Auto based on a regression

[4] Oliver Wyman Public Bus Report, January 26, 2018, page 12.
[5] The two time periods used were 1997-1 to 2004-1 and 2004-2 to 2016-2.
[6] The two time periods used were 1997-1 to 2011-1 and 2011-2 to 2016-2.

analysis of its estimate of Industry Commercial Vehicles average claim cost by accident half-year over the 20-year period ending December 31, 2016, excluding 8 data points considered by Facility to be outliers. Oliver Wyman submitted that the Uninsured Auto Industry Commercial Vehicle data has on average 2 claims each accident half-year and in some cases there are no claims. Oliver Wyman found the Uninsured Auto data to be too thin and volatile upon which to determine a loss trend rate and therefore based its selection of +8.5% for Uninsured Auto on its Accident Benefits selection. Given the relatively limited Uninsured Automobile data, Oliver Wyman found its approach and selected trend rate to be more reasonable.

For Comprehensive coverage Oliver Wyman found Facility's selected severity trend rate to be unreasonable. Facility determined its severity trend rate of 0.0% for this coverage based on a regression analysis of its estimate of Industry Commercial Vehicle ultimate average claim cost by accident half-year over the 20-year period ending December 31, 2016, with no segmentation of time periods. Oliver Wyman found that the difference in severity trend rate was due to the time periods over which the severity trend is modelled. Based on its analysis Oliver Wyman selected a trend rate of +4.0%, but noted a wide confidence interval around its selected trend rate. Nevertheless, Oliver Wyman found its selected severity trend rate to be reasonable.

Facility raised several issues with regards to Oliver Wyman's findings on its estimated loss trend rates. Facility submitted that the underlying trends that reflect changes over time is an unknown, and actuarial judgement is applied in proposing models to describe a relationship between variables. Facility also commented on Oliver Wyman's application of the July 1, 2016 HST rate change and disagreed that Oliver Wyman's approach leads to a higher estimate of the trend rate as the HST rate change would only impact a single data point. Facility submitted that it believes all of its trend model selections are statistically supported.

The Board acknowledges that selecting loss trend rates is a matter of actuarial judgement; however, this judgement must be fully justified to demonstrate that the resulting rates are not too high. The Board also notes that, in its selected loss trend rates as of December 31, 2016 prepared for the Board, Oliver Wyman found a gradual year-to-year decline to be a more realistic representation of the frequency trend pattern, particularly over the experience period 2013 through 2016. As noted by Oliver Wyman this gradual decline has also been found in other insurers' models for NL that have been reviewed. Facility's approach in this application was a similar approach as used in its recent Private Passenger Automobiles ("PPA") filing which was not accepted by the Board. The Board finds that Facility has not adequately justified with supporting information the exercise of its judgement in relation to its selection of loss trend rates for Bodily Injury, Property Damage, Accident Benefits, Uninsured Auto and Comprehensive coverages.

4.2 HST Adjustment

The HST rate increased in the province on July 1, 2016 from 13% to 15%, an increase of 1.77%. In the Application Facility applied an HST adjustment factor of 1.0177 to all coverages except Accident Benefits and Bodily Injury. For these coverages Facility applied an HST adjustment factor of 1.012 on the basis that, since the HST does not apply to the Accident Benefits-Disability Income sub-coverage, approximately two-thirds of the total Accident Benefits costs are affected and that Bodily Injury would be similar to Accident Benefits. In addition, Facility adjusted its complement of credibility loss ratio by a HST adjustment factor of 1.0177 for all coverages.

Oliver Wyman accepted the HST adjustment for all coverages other than Bodily Injury. Oliver Wyman also did not agree with Facility's selection of different HST adjustment factors for Bodily Injury and Accident Benefits for its complement of credibility. Oliver Wyman calculated that applying an alternate HST adjustment factor of 1.0053 instead of Facility's 1.012 to the Bodily Injury coverage, and applying 1.0053 to Bodily Injury coverage and 1.012 to Accident Benefits coverage to adjust the complement of credibility loss ratio instead of Facility's 1.0177, and no other changes in assumptions, the overall rate level indication would reduce by approximately 0.6%.

In Order No. A.I. 21(2018) in relation to Facility's PPA filing the Board discussed the HST adjustment and complement of credibility. Those comments are applicable to this application. The Board accepts the HST adjustments proposed by Facility for all coverages except Bodily Injury. In addition, as noted by Oliver Wyman, Facility's selection of different and higher adjustment factors to be applied to Accident Benefits and Bodily Injury for the complement of credibility are inconsistent with the HST adjustment factors applied elsewhere in the Application. The Board finds that Facility's selections for the HST adjustment factors for Bodily Injury coverage and to the complement of credibility loss ratios result in overall rate indications that are too high. Oliver Wyman has provided support for its alternate HST adjustment factors for this coverage and ratios and the Board accepts these as reasonable.

4.3 Finance Fee Revenues

Facility does not include in its rate level indication the revenue impact associated with finance fees paid by policyholders. While the Board's Guidelines require finance fee revenue to be reflected in rates, Facility's position has been that monthly financing plans are provided and administered by Servicing Carriers, which also assumes all related expenses and risks.

Section 6.3(3) of the *Automobile Insurance Act* requires all insurers in NL to provide a monthly payment plan for insureds. It is common practice in the industry that finance fee revenues associated with monthly payment plans be reflected as an offset in assessing rate levels. This issue was addressed by the Board in Order Nos. A.I. 27(2013) and A.I. 21(2018) arising from Facility's recent PPA rate filings.

In its review of the Application Oliver Wyman raised the issue of finance fees but acknowledged limited finance fees appear to be collected for this class of business. As a result, Oliver Wyman did not comment further on this issue but recommended that Facility take all fees into consideration for any future rate applications.

As stated in Order No. A.I. 21(2018), the Board's view is that finance fee revenues should be reflected in rates since they are revenues collected by insurers in premiums paid monthly. In the interest of fairness and consistency all insureds should receive the benefit of offsetting revenues associated with premium financing plans in setting rates. For the Public Bus class of business it appears that only one servicing carrier charges a fee for its monthly payment plan and that limited finance fees are collected. In these circumstances the Board will accept that no finance fee revenue be included in the proposed rates. Future rate applications from Facility should include information on finance fee revenue.

5. Conclusions

The Board accepts Facility's proposals and assumptions contained in the filing with the exception of Facility's (i) loss trend rates and (ii) adjustment for the HST rate change.

Based on the record for this Application the Board accepts that a rate increase for Facility's Public Bus class of business appears to be justified, although not at the level proposed by Facility. Facility may file a revised application incorporating the Board's findings in this Decision and Order.

6. Order

<u>IT IS THEREFORE ORDERED THAT:</u>

1. The Application by Facility Association is denied.

2. Facility Association will pay all costs of the Board, including the cost of the actuarial review, arising from this Application.

DATED at St. John's, Newfoundland and Labrador, this 13th day of July, 2018.

Darlene Whalen, P. Eng., FEC
Chair & CEO

John O'Brien, FCPA, FCA, CISA
Commissioner

Sara Kean
Assistant Board Secretary