

1 **A.I. 1(2006)**

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4 **IN THE MATTER OF** the *Automobile,*
5 *Insurance Act*, R.S.N.L. 1990, c. A-22, as
6 amended (the “*Act*”)

7
8 **AND**

9
10 **IN THE MATTER OF** an application by
11 Security National Insurance Company
12 (the “Applicant”) to implement revised rates
13 for its Private Passenger class of business.
14

15
16 On September 14, 2005, pursuant to legislative changes enacted on August 1, 2005, the Applicant
17 submitted for the Board’s review and approval, a revised private passenger automobile insurance
18 rating program for use with effect from August 1, 2005.

19
20 **Legislation**

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22 On August 1, 2005 the Government of Newfoundland and Labrador enacted legislation amending
23 the *Automobile Insurance Act* and the *Insurance Companies Act* in relation to the conduct of
24 participants in the automobile insurance industry and the regulation of rates in the province. Among
25 other things, the changes eliminated the benchmarking system of rate review and approval used by
26 the Board since inception of automobile insurance rate regulation and substituted new rate review
27 requirements.
28

29 Under the revised automobile insurance legislation, rate decreases take effect no sooner than thirty
30 days following filing with the Board. Rate increases are subject to prior approval and in connection
31 therewith, the Board must determine, in accordance with provisions outlined in regulations, if a
32 proposed rate is “too high”. Where such a finding is made the Board is required to prohibit, or vary
33 the rates.

1 In arriving at a determination with respect to rate increases the Board considers the documentation
2 available with respect to the justification of the rate levels including: the Applicant's projected loss
3 experience; expenses; investment income for the company's automobile insurance business for the
4 province; and other elements considered appropriate by the Board. While each of these components
5 is, with certain exceptions, relatively easy to calculate, it is the aspect of the reasonableness of each
6 component that must be assessed by the Board in determining if rates are "too high". Where the
7 Board determines that an insurer's loss experience is not relevant, inadequate or otherwise
8 unreasonable for use in establishing rates, the Board has discretion to establish the elements and
9 information upon which the insurer shall file its projected loss experience.

10
11 In addition to the new rate regulation process generally, the amended legislation also provided for a
12 one time reduction in rates. The legislation states as follows:

- 13
14 **"62.1 (2)** *Effective August 1, 2005, the rates for all types of coverage charged by an insurer for private*
15 *passenger automobile insurance as approved by the Board shall be reduced by at least 5%.*
16 **(3)** *Not later than September 1, 2005, an insurer that is reducing its rates by at least 5% shall*
17 *file with the Board the rates for all types of coverage it proposes to charge for private*
18 *passenger automobile insurance."*
19

20 Where rates are not reduced by at least 5%, the legislation states:

- 21
22 **"(4)** *Notwithstanding subsection (2), an insurer may, not later than September 1, 2005, apply to*
23 *the Board for the approval of rates that have not been reduced by at least 5% and the Board*
24 *shall approve, prohibit or vary the rates proposed to be charged by the insurer."*
25

26 It is under this latter provision that the within filing has been made.

27
28 Other significant revisions affecting rates or the rating of insureds introduced with the amended
29 legislation to take effect from August 1, 2005 include:

- 30
31 a. Elimination of Age, Sex and Marital Status as rating variables;
32 b. Establishment of a new Class of Use system and definitions;

- 1 c. Permitting the use of the number of years licensed for rating purposes;
- 2 d. Additions to the Prohibited Underwriting Regulations;
- 3 e. Additions to the elements prohibited in a company's Risk Classification System;
- 4 f. Additions to restrictions on the grounds that can be used to decline, terminate or refuse to
- 5 renew coverage; and
- 6 g. Elimination of the prohibition on group rates and group rating.

7 **Filing Instructions**

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11 On July 29, 2005, following the legislated changes to the automobile insurance product and changes
12 to the method of rate regulation, the Board issued new Filing Instructions to industry participants.
13 These Filing Instructions detailed the requirements arising from the new legislation and in particular
14 the changes to the information requirements respecting rate filings. Extracts from the Filing
15 Instructions providing definitions of the two types of filing categories appear below:

16 17 ***"3.1 CATEGORY - 1***

18 19 ***3.1.1 Category 1 - Definition***

20
21 *An insurer is considered to have made a Category 1 filing where:*

- 22
23 *a) In the case of private passenger rates filed in accordance with s.62.1, filed and*
- 24 *adjusted base rates for every coverage are reduced by at least 5% and there is no*
- 25 *increase to any rate for any coverage for any insured;*
- 26 *b) In the case of private passenger rates other than those filed in accordance with*
- 27 *s.62.1, there is no increase to any rate for any coverage for any insured; or*
- 28 *c) In the case of commercial or miscellaneous vehicle rates there is no increase to any*
- 29 *rate for any coverage for any insured.*

30
31 *Any filings not meeting this requirement will be considered a Category 2 filing.*

32

1 **3.2 CATEGORY 2- GENERAL FILING**

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3 **3.2.1 Category 2 - Definition**

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5 *Where a rate filing contemplates changes to base rates less than the 5% mandated by*
6 *legislation on September 1, 2005 or in any other case an increase in a rate for any coverage*
7 *for any insured, the filing will be considered a Category 2 filing.”*
8

9 As part of the Filing Instructions the Board also issued a guidance document which sets out details
10 as to how the filing is to be made and the standards to be applied. Specifically, insurers were
11 advised:

12
13 *“Insurers should have reference to the Category 2 Rate Application Guidance Document which is*
14 *attached to these Filing Guidelines as Appendix A. Insurers should note that this document sets out*
15 *guidance on completion requirements and various assumptions for such parameters as the trend*
16 *factor, loss development factors, credibility, ROE, ROI and premium to surplus ratio. To the extent*
17 *that insurers vary from the Category 2 Rate Application Guidance Document they will be required to*
18 *provide complete justification for consideration by the Board. Insurers should note that the Board*
19 *may have reference to advice from its consultants or may hold a hearing to consider these*
20 *proposals.”*
21

22 While an Applicant may utilize factors at variance with those set out in the filing guidelines, it is
23 required to provide compelling information to assist in the Board’s assessment of these factors. It is
24 in the context of the foregoing that the within application is reviewed.

25
26 **The Application**

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28 On September 14, 2005 the Applicant submitted to the Board for consideration a detailed filing of
29 proposed private passenger automobile insurance rates. A copy of the filing was forwarded to the
30 Board’s actuarial consultants, Mercer Oliver Wyman (MOW), for their review and report.
31 Throughout the ensuing weeks various information requests were issued by MOW to the Applicant
32 and responses received such that it was not until October 27, 2005 that a final filing was considered
33 to have been made and MOW could complete its review and issue its report.
34

1 The filing proposed a schedule of rates based on a Return on Equity (ROE) of 15%, a Return on
 2 Investment (ROI) of 3.2% and a Premium to Surplus Ratio of 2.25:1. These parameters, as well as
 3 the assumptions made by the Applicant in connection with other factors in the rate making process,
 4 are reflected in the indications and proposed rate changes shown below:

Security National	Company	Company
Coverage	Indications	Proposal
Third Party Liability	22.1%	-2.8%
Accident Benefits	77.4%	18.0%
Collision	-8.9%	-11.2%
Comprehensive	-34.8%	-22.9%
Uninsured Motorist	60.3%	0.0%
Total	10.2%	-5%
Total (with capping)	-	-7.8%

6
 7 Where a person insured with the Applicant would upon renewal experience an increase as a result of
 8 changes flowing from this application or the amended legislation, the Applicant proposes to cap the
 9 rate increase at 0% for the first renewal of their policies after these changes.

10
 11 The Applicant proposes to offer the following discounts:

DISCOUNT	%	COVERAGES
Multi Vehicle	10%	Third Party Liability, All Perils, Collision, Comprehensive, Specified Perils; All Classes except Class 05
Accident Free	5%	Third Party Liability, Accident Benefits, Uninsured Motorist, All Perils, Collision; All Classes, except Class 05
Occasional Driver	50%	Third Party Liability, All Perils and Collision; Class 05 Only
Alarm and Anti-Theft System	10% - 20%	Comprehensive and Specified Perils; All Classes except Class 05
Multi Product	5%	All Coverages and All Classes, except Class 05
Age	10%	Third Party Liability, All Perils, Collision, Comprehensive, Specified Perils; Classes 01,02,03,07
Group	10% - 15%	Third Party Liability, All Perils, Collision, Comprehensive, Specified Perils; All Classes except Class 05
More Vehicles Than Drivers	12.5%	Third Party Liability, All Perils, Collision, Comprehensive, Specified Perils; All Classes except Class 05

1 The proposed discounts are consistent with those previously approved, with the addition of a new
2 Group discount, Age discount and Alarm and Anti-Theft System discount as well as an increase to
3 the Multi-Vehicle and More Vehicles Than Drivers discount. The proposed discounts relate to the
4 risk, are not subjective or arbitrary, and are in accordance with the legislative provisions. In addition
5 the impact of the discounts has been appropriately reflected in the rate filing, as reviewed by MOW.

6
7 The Applicant proposes Class of Use definitions that vary from those recently amended in the
8 Statistical Plan of the Superintendent of Insurance. These definitions were part of the Applicant's
9 last rate filing and were accepted as reasonable by the Board at that time. MOW has reviewed the
10 proposed Class of Use definitions and found them to be similar to those set out in the Superintendent
11 of Insurance's Statistical Plan. MOW has also concluded that the selected class differentials are
12 reasonable.

13
14 **Detailed Analysis**

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16 In its review of rate filings the Board is mandated to prohibit or vary a rate which it determines is
17 "too high". The Board makes this determination following a thorough review of all information
18 submitted by the Applicant and careful consideration of the reports and findings of its expert
19 consultants. In relation to the Group discount the Applicant has proposed to offer smaller discounts
20 than the actuarial indications suggest is appropriate in the circumstances. As the Board is required
21 to prohibit or vary rates which are too high the proposed discounts cannot be approved.

22
23 In exercising its jurisdiction the Board reviews the base rates for each coverage and a determination
24 is made as to whether or not they are "too high". That is to say, the review is on a coverage by
25 coverage basis. This is consistent with the amended legislation and is in keeping with the historical
26 practice of the Board which was adopted to avoid the cross subsidization of rates between coverages.
27 Allowing the establishment of a rate for one coverage lower than is justified and permitting a rate for
28 another coverage to be higher than is justified by the actuarial and other evidence would result in
29 rates which are not reflective of costs and, depending on the coverage chosen, may cause some

1 insureds to pay more than actuarially justified.

2

3 As identified in the Board's detailed Filing Instructions, the Applicant is required to provide
4 justification of any rate increases. Where the Applicant does not utilize the specific parameters set
5 out in the filing guidelines the Applicant is required to provide the Board with sound reasoning and
6 justification for the deviation. For example, in connection with ROI, the guidelines provide the
7 Board's acceptable range of factors but state, "*The Board will consider other return on investment*
8 *assumptions or calculations; however, full rationale for any deviations must be provided, based on*
9 *recently available 2004 financial data.*" Similar cautions and directions are provided in connection
10 with the remaining guideline factors and assumptions, where appropriate.

11

12 Actuarial

13

14 The November 17, 2005 report of the Board's actuarial consultants identified a number of issues and
15 provided rate indications based on alternate assumptions found by MOW to be reasonable and
16 supported by the information contained in the Applicant's filings, or, reasonable on the basis of
17 industry factors.

18

19 In respect to assumptions made in the determination of rates, these are matters of actuarial judgment
20 and are reviewed in the context of reasonableness. MOW reviewed the assumptions made by the
21 Applicant and expressed the opinion that certain of the assumptions were not fully supported. In
22 their place, MOW substituted alternate assumptions they felt more appropriate or reflective of
23 market or other conditions as follows:

24

- 25 ○ Expense provision – the Applicant did not allocate any of the fixed expenses to the
26 property damage coverages. All fixed costs were allocated to third party liability,
27 uninsured motorist and accident benefits coverage. The effect of this is to
28 overstate costs of those coverages to which the expense is allocated and to
29 understate costs of other coverages. The actuary felt it more appropriate to

1 allocate fixed expenses to all coverages.

- 2
- 3 ○ Effects of Reform - the Applicant did not provide for any savings arising from the
- 4 Collateral Sources provision in recent legislative changes thus overstating the cost
- 5 of the product. The savings were provided as part of the Board's Filing
- 6 Instructions.
- 7
- 8 ○ Credibility Standard/Procedure – The Applicant used a credibility standard of
- 9 3,246 for third party liability. MOW uses the same number of claims for the
- 10 bodily injury portion of third party liability but a lower number, 1082 claims, for
- 11 the property damage portion. This is consistent with past practice of the Board in
- 12 assessing benchmarks rates and is the standard used by the Board's consultant in
- 13 the past when reviewing independent rate filings.
- 14
- 15 ○ Accident Year Weights - the Applicant's accident year weights give a higher
- 16 weight to older data. For 2000 – 2004 the weights are 14%, 14%, 17%, 25% and
- 17 30%. MOW notes that actuaries generally give more weight to more recent data
- 18 and recommend weights of 10%, 15%, 20%, 25% and 30%.
- 19

20 The impacts of these alternative assumptions are provided in detail in an appendix to the

21 consultant's report and are summarized in the table below:

Security National	Company	Company	MOW
Coverage	Indications	Proposal	Indications
Third Party Liability	22.1%	-2.8%	1.5%
Accident Benefits	77.4%	18.0%	56.2%
Collision	-8.9%	-11.2%	-2.4%
Comprehensive	-34.8%	-22.9%	-27.0%
Uninsured Motorist	60.3%	0.0%	39.1%
Total	10.2%	-5.0%	-0.8%
Total (with capping)	-	-7.8%	-

1 The MOW indications are based on the Board's guideline factors for ROE, ROI and Premium to
2 Surplus Ratio.

3
4 Cost of Capital

5
6 The Category 2 Rate Application Guidance Document set out the parameters regarding ROE, ROI
7 and Premium to Surplus Ratio as follows:

8
9 Return on Equity

- 10
11
 - 12 *▪ In Order No. A.I. 1 (2005), after hearing from several experts relating to profit margin, the Board*
13 *determined a return on equity and premium to surplus ratio for use under the benchmark system*
14 *which, as the result of legislative changes, is no longer in use. Nevertheless, the Board accepts the*
15 *determination in Order No. A.I. 1 (2005) as the most comprehensive recent consideration of the*
16 *appropriate return on equity and premium to surplus ratio for rate making purposes for automobile*
17 *insurers in Newfoundland & Labrador. Therefore, the Board accepts as reasonable for use in rate*
18 *filings a target after-tax Return on Equity of 10.0% and a premium to surplus ratio of 2.25.*

 - 19 *▪ Other return on equity or premium to surplus assumptions or calculations will be considered, but*
20 *rationale for any deviations must be provided and the Company must provide a comparison of the*
21 *assumptions or calculations with those made by the Company in preparing filed rate level indications*
22 *for other coverages and lines of business in Newfoundland & Labrador as well other provinces.*

23 Return on Investments

- 24
 - 25 *▪ The Board also considered the appropriate return on investments for ratemaking purposes for*
26 *automobile insurers in Newfoundland and Labrador in Order No. A.I. 1 (2005). The Board accepted*
27 *that "...setting ROI based on levels of risk and commensurate returns relative to the actual*
28 *investment profile of Canadian automobile insurers is most appropriate," but noted the lack of*
29 *available information to assist in this determination. In light of the lack of information and the*
30 *changed regulatory environment, the Board will not set out a target return on investment for rate*
31 *making purposes, but expects that the return on investment will be in the range identified by the*
32 *Board in Order No. A.I. 1 (2005) of 5.4%-7.04%.*

 - 33 *▪ The Board will consider other return on investment assumptions or calculations; however, full*
34 *rationale for any deviations must be provided, based on recently available 2004 financial data."*

35 The filing was reviewed by the Board's cost of capital consultants, National Economic Research Associates (NERA), as relates to the ROE and ROI inputs. During this review information requests

1 and responses were exchanged with the Applicant. NERA’s report, dated March 13, 2006, details
 2 the pertinent aspects of these exchanges and summarizes the position stated by the Applicant in
 3 support of the requested ROE and ROI and NERA’s consideration thereof.

4

5 NERA’s final report findings are as follows:

6

7 ROE – *“Security National has not provided sufficient evidence to support its request for an ROE*
 8 *higher than set out in the guidelines.”*

9

10 ROI – *“Security National’s requested ROI is not justified. Based on the proxy portfolio, NERA’s*
 11 *calculated ROI for Security National is 3.86%.”*

12

13 A copy of the MOW report and the NERA report was forwarded to the Applicant for comment.

14

15 **Revised Proposal**

16

17 On March 22, 2006 the Applicant notified the Board that it wished to amend its rating proposal
 18 having given consideration to the reports of the Board’s actuarial and cost of capital consultants.

19 The Applicant’s revised proposals were reviewed by MOW and set out in an addendum report dated
 20 March 23, 2006. The revisions and revised MOW indications are shown in the following table:

Security National	Company	Company	MOW
Coverage	Indications	Proposal	Indications
Third Party Liability	5.5%	-2.3%	5.7%
Accident Benefits	61.7%	18.0%	61.6%
Collision	-1.3%	-11.2%	-1.4%
Comprehensive	-26.1%	-26.3%	-26.1%
Uninsured Motorist	44.7%	0.0%	44.6%
Total	2.2%	-5.0%	2.4%

21 These indications are based on the alternate assumptions of MOW and NERA, including an ROE of
 22 10%, an ROI of 3.86% and a Premium to Surplus Ratio of 2.25:1.

23

1 **Findings**

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3 The Board has reviewed the application, the supporting material, responses to information requests,
4 consultants' reports, and all other information relevant to this rate filing. Based on the review of the
5 available documentation the Board is satisfied that the Applicant's March 22, 2006 rate proposals
6 are reasonably supported by the available information.

7

8 While the original proposals were at a substantial variance to those indicated by the Board's
9 consultants, the Applicant revised its proposals on March 22, 2006 proposing rates consistent with
10 the indications of both the Board's consulting actuaries and cost of capital consultants. The
11 proposed Class of Use definitions are in line with the recent changes implemented by the
12 Superintendent of Insurance and the Board's previously approved definitions. As well the
13 associated differentials were found by MOW to be reasonable. Similarly the proposed discount
14 provisions reflect the statutorily required removal of age, gender and marital status and have been
15 determined to be reasonable in the context of the rate filing. The proposed capping of rate increases
16 for renewals is consistent with the legislative provisions and will minimize significant rate impacts
17 arising out of this application.

18

19 In accordance with the legislation the Board will prohibit or vary any rate that is too high. A
20 proposed rate for any coverage will be found to be too high where it is greater than the indications
21 which are determined by the Board to be reasonable. In this filing, the proposals with respect to
22 each base coverage are the same as or lower than the indications of the Board's actuaries. The
23 Board is satisfied that the proposals reflect the indications for all base coverages. The Board
24 therefore accepts the March 22, 2006 revised rate proposal for all coverages.

25

1 **Costs**

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3 As set out in the Filing Instructions, pursuant to section 57 of the *Automobile Insurance Act* and
4 section 90 of the *Public Utilities Act*, the Applicant will be required to pay the costs of the Board
5 associated with this application.

6

7 **IT IS THEREFORE ORDERED THAT:**

8

9 1. The Applicant's March 22, 2006 rate proposals are approved.

10

11 2. The Applicant shall file with the Board revised rate manual pages and rate tables consistent
12 with the March 22, 2006 proposal setting out the dates on which the revised rates are
13 effective.

14

15 3. The proposed discount program is approved.

16

17 4. The proposed Class of Use definitions are accepted for use.

18

19 5. The Applicant shall pay all the expenses of the Board arising from this application.

20

DATED at St. John's, Newfoundland and Labrador, this 30th day of March 2006.

Robert Noseworthy
Chair & Chief Executive Officer

Darlene Whalen, P.Eng.
Vice-Chair

G. Cheryl Blundon
Board Secretary