

A.I. 4(2006)

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

7 **AND**  
8

9 **IN THE MATTER OF** an application by  
10 TD Home and Auto Insurance Company  
11 (the “Applicant”) to implement revised rates  
12 for its Private Passenger class of business.  
13  
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15 On September 14, 2005, pursuant to legislative changes enacted on August 1, 2005, the  
16 Applicant submitted for the Board’s review and approval a revised private passenger automobile  
17 insurance rating program for use with effect from August 1, 2005.

18  
19 **Legislation**  
20

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

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

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

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

- 15  
16 *"62.1 (2) Effective August 1, 2005, the rates for all types of coverage charged by an insurer for*  
17 *private passenger automobile insurance as approved by the Board shall be reduced by at*  
18 *least 5%.*  
19 *(3) Not later than September 1, 2005, an insurer that is reducing its rates by at least 5%*  
20 *shall file with the Board the rates for all types of coverage it proposes to charge for*  
21 *private passenger automobile insurance."*  
22

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

- 24  
25 *"(4) Notwithstanding subsection (2), an insurer may, not later than September 1, 2005, apply*  
26 *to the Board for the approval of rates that have not been reduced by at least 5% and the*  
27 *Board shall approve, prohibit or vary the rates proposed to be charged by the insurer."*  
28

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

30  
31 Other significant revisions affecting rates or the rating of insureds introduced with the amended  
32 legislation to take effect from August 1, 2005 include:

- 33  
34 a. Elimination of Age, Sex and Marital Status as rating variables;  
35 b. Establishment of a new Class of Use system and definitions;

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

## **Filing Instructions**

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

### **“3.1 CATEGORY - 1**

#### **3.1.1 Category 1 - Definition**

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

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

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

### **3.2 CATEGORY 2- GENERAL FILING**

#### **3.2.1 Category 2 - Definition**

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

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

5  
6 *“Insurers should have reference to the Category 2 Rate Application Guidance Document which is*  
7 *attached to these Filing Guidelines as Appendix A. Insurers should note that this document sets*  
8 *out guidance on completion requirements and various assumptions for such parameters as the*  
9 *trend factor, loss development factors, credibility, ROE, ROI and premium to surplus ratio. To*  
10 *the extent that insurers vary from the Category 2 Rate Application Guidance Document they will*  
11 *be required to provide complete justification for consideration by the Board. Insurers should*  
12 *note that the Board may have reference to advice from its consultants or may hold a hearing to*  
13 *consider these proposals.”*  
14

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

18  
19 **The Application**

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21 On September 14, 2005 the Applicant submitted to the Board for consideration a detailed filing  
22 of proposed private passenger automobile insurance rates. A copy of the filing was forwarded to  
23 the Board’s actuarial consultants, Mercer Oliver Wyman (MOW), for their review and report.  
24 Throughout the ensuing weeks various information requests were issued by MOW to the  
25 Applicant and responses received such that it was not until November 25, 2005 that a final filing  
26 was considered to have been made and MOW could complete its review and issue its report.

27  
28 The filing proposed a schedule of rates based on a Return on Equity (ROE) of 15%, a Return on  
29 Investment (ROI) of 3.2% and a Premium to Surplus ratio of 2.25:1. These parameters, as well  
30 as the assumptions made by the Applicant in connection with other factors considered in the rate  
31 making process are reflected in the indications and the proposed rate changes shown below:  
32

1

<b>TD Home and Auto Coverage</b>	Company Indications	Company Proposal
Third Party Liability	2.5%	-1.4%
Accident Benefits	61.3%	-9.7%
Collision	10.3%	-3.6%
Comprehensive	-35.0%	-31.2%
Uninsured Motorist	81.3%	-1.9%
Total	1.8%	-5.0%

2

3 The Applicant proposes to offer the following discounts:

4

<b>DISCOUNT</b>	<b>%</b>	<b>COVERAGES</b>
Multi Vehicle	10% or 15%	All Coverages and All Classes, except Class 05
Preferred Auto Rating	15%	Third Party Liability and Collision; All Classes, except Class 05
Occasional Driver	50%	Third Party Liability, All Perils and Collision; Class 05 Only
Alarm and Anti-Theft System	15%	Comprehensive and Specified Perils; All Classes except Class 05
Farmers	20%	Third Party Liability and Collision; All Classes, except Class 05
Age	10%	Third Party Liability and Collision; Classes 01,02,03,07 and 14

5

6 The proposed discounts are consistent with those previously approved. These discounts relate to  
7 the risk, are not subjective or arbitrary, and are in accordance with the legislative provisions.8 The impact of the discounts has been appropriately reflected in the rate filing, as reviewed by  
9 MOW.

10

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

17

## Detailed Analysis

In its review of rate filings the Board is mandated to prohibit or vary a rate which it determines is “too high”. The Board makes this determination following a thorough review of all information submitted by the Applicant and careful consideration of the reports and findings of its expert consultants. In exercising its jurisdiction the Board reviews the base rates for each coverage and a determination is made as to whether or not they are “too high”. That is to say, the review is on a coverage by coverage basis. This is consistent with the amended legislation and is in keeping with the historical practice of the Board which was adopted to avoid the cross subsidization of rates between coverages. Allowing the establishment of a rate for one coverage lower than is justified and permitting a rate for another coverage to be higher than is justified by the actuarial and other evidence would result in rates which are not reflective of costs and, depending on the coverage chosen, may cause some insureds to pay more than actuarially justified.

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

## Actuarial

The December 5, 2005 report of the Board’s actuarial consultants identified a number of issues and provided rate indications based on alternate assumptions found by MOW to be reasonable and supported by the information contained in the Applicant’s filing or reasonable on the basis of industry factors.

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

- 6
- 7 ○ Expense provision – the Applicant did not allocate any of the fixed expenses to the  
8 property damage coverages. All fixed costs were allocated to third party liability,  
9 uninsured motorist and accident benefits coverage. The effect of this is to overstate costs  
10 of those coverages to which the expense is allocated and to understate costs of other  
11 coverages. The actuary felt it more appropriate to allocate fixed expenses to all coverages.  
12
- 13 ○ Effects of Reform - the Applicant did not provide for any savings arising from the  
14 Collateral Sources provision in recent legislative changes thus overstating the cost of the  
15 product. The savings were provided as part of the Board’s Filing Instructions.  
16
- 17 ○ Credibility Standard/Procedure – The Applicant used a credibility standard of 3,246 for  
18 third party liability. MOW uses the same number of claims for the bodily injury portion of  
19 third party liability but a lower number, 1082 claims, for the property damage portion.  
20 This is consistent with past practice of the Board in assessing benchmarks rates and is the  
21 standard used by the Board’s consultants in the past when reviewing independent rate  
22 filings.  
23
- 24 ○ Accident Year Weights - the Applicant’s accident year weights give a higher weight to  
25 older data. For 2000 – 2004 the weights are 22%, 22%, 20%, 19% and 17%. MOW notes  
26 that actuaries generally give more weight to more recent data and recommend weights of  
27 10%, 15%, 20%, 25% and 30%.

28

29 The impacts of these alternative assumptions are provided in detail as an appendix to the  
30 consultant’s report and are summarized in the table below:

31

<b>TD Home and Auto Coverage</b>	<b>Company Indications</b>	<b>Company Proposal</b>	<b>MOW Indications</b>
Third Party Liability	2.5%	-1.4%	-14.2%
Accident Benefits	61.3%	-9.7%	40.0%
Collision	10.3%	-3.6%	15.3%
Comprehensive	-35.0%	-31.2%	-26.7%
Uninsured Motorist	81.3%	-1.9%	57.9%
Underinsured Motorist	-95.3%	0.0%	-85.6%
Total	1.8%	-5.0%	-7.9%

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

4  
5 Cost of Capital

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

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10 Return on Equity

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- *In Order No. A.I. 1 (2005), after hearing from several experts relating to profit margin, the Board determined a return on equity and premium to surplus ratio for use under the benchmark system which, as the result of legislative changes, is no longer in use. Nevertheless, the Board accepts the determination in Order No. A.I. 1 (2005) as the most comprehensive recent consideration of the appropriate return on equity and premium to surplus ratio for rate making purposes for automobile insurers in Newfoundland & Labrador. Therefore, the Board accepts as reasonable for use in rate filings a target after-tax Return on Equity of 10.0% and a premium to surplus ratio of 2.25.*
  - *Other return on equity or premium to surplus assumptions or calculations will be considered, but rationale for any deviations must be provided and the Company must provide a comparison of the assumptions or calculations with those made by the Company in preparing filed rate level indications for other coverages and lines of business in Newfoundland & Labrador as well other provinces.*

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24  
25 Return on Investments

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- *The Board also considered the appropriate return on investments for ratemaking purposes for automobile insurers in Newfoundland and Labrador in Order No. A.I. 1 (2005). The Board accepted that "...setting ROI based on levels of risk and commensurate returns relative to the actual investment profile of Canadian automobile insurers is most appropriate," but noted the lack of available information to assist in this determination. In light of the lack of information and the changed regulatory environment, the Board will not set out a target return on investment*



1           *for rate making purposes, but expects that the return on investment will be in the range identified*  
2           *by the Board in Order No. A.I. 1 (2005) of 5.4%-7.04%.*

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

5  
6           The filing was reviewed by the Board’s cost of capital consultants, National Economic Research  
7           Associates (NERA), as relates to the ROE and ROI inputs. During this review information  
8           requests and responses were exchanged with the Applicant. The consultant’s report, dated  
9           March 13, 2006, details the pertinent aspects of these exchanges and summarizes the position  
10          stated by the Applicant in support of the requested ROE and ROI and NERA’s consideration  
11          thereof.

12  
13          NERA’s final report findings are as follows:

14                 ROE – *“TDHA has not provided sufficient evidence to support its request for an ROE higher*  
15                 *than set out in the guidelines.”*

16  
17                 ROI – *“TDHA requested ROI is not justified. Based on the proxy portfolio, NERA’s calculated*  
18                 *ROI for TDHA is 3.86%.”*

19  
20          A copy of the MOW report and the NERA report was forwarded to the Applicant for comment.

21  
22          **Revised Proposal**

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24          On March 22, 2006 the Applicant notified the Board that it wished to amend its rating proposal  
25          having given consideration to the reports of the Board’s actuarial and cost of capital consultants.  
26          The Applicant’s revised proposals were reviewed by MOW and set out in an addendum report  
27          dated March 23, 2006. The revisions and revised MOW indications are shown in the following  
28          table:

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<b>TD Home and Auto Coverage</b>	<b>Company Indications</b>	<b>Company Proposal</b>	<b>MOW Indications</b>
Third Party Liability	-10.7%	-10.7%	-10.6%
Accident Benefits	45.2%	37.3%	45.0%
Collision	16.5%	9.3%	16.5%
Comprehensive	-25.7%	-26.3%	-25.7%
Uninsured Motorist	64.7%	37.3%	64.5%
Total	-4.9%	-5.0%	-4.9%

2

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

5

### 6 **Findings**

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8 The Board has reviewed the application, the supporting material, responses to information  
9 requests, consultants' reports, and all other information relevant to this rate filing. Based on the  
10 review of the available documentation the Board is satisfied that the Applicant's current rate  
11 proposals are reasonably supported by the available information.

12

13 While the original proposals were at a substantial variance to those indicated by the Board's  
14 consultants, the Applicant revised its proposals on March 22, 2006 proposing rates consistent  
15 with the indications of both the Board's consulting actuaries and cost of capital consultants. The  
16 proposed Class of Use definitions are in line with the recent changes implemented by the  
17 Superintendent of Insurance and the Board's previously approved definitions. As well the  
18 associated differentials were found by MOW to be reasonable. Similarly the proposed discount  
19 provisions are generally consistent with those previously approved. Changes to the discount  
20 program reflect statutorily required removal of age, gender and marital status and have been  
21 determined to be reasonable in the context of the rate filing.

22

23 In accordance with the legislation the Board will prohibit or vary any rate that is too high. A  
24 proposed rate for any coverage will be found to be too high where it is greater than the  
25 indications which are determined by the Board to be reasonable. In this filing, the proposals with

1 respect to each base coverage are the same as or lower than the indications of the Board's  
2 actuaries. The Board is satisfied that the proposals reflect the indications for all base coverages.  
3 The Board therefore accepts the March 22, 2006 revised rate proposal for all coverages.

4  
5 **Costs**

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

10

11 **IT IS THEREFORE ORDERED THAT:**

12

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

14

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

18

19 3. The proposed discount program is approved.

20

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

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

**DATED** at St. John's, Newfoundland and Labrador, this 30<sup>th</sup> day of March 2006.

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Robert Noseworthy  
Chair & Chief Executive Officer

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Darlene Whalen, P.Eng.  
Vice-Chair

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G. Cheryl Blundon  
Board Secretary