

**NEWFOUNDLAND AND LABRADOR
BOARD OF COMMISSIONERS OF PUBLIC UTILITIES**

AN ORDER OF THE BOARD

NO. A.I. 4(2016)

1 **IN THE MATTER OF** the *Automobile*
2 *Insurance Act*, RSNL 1990, c. A-22, as
3 amended; and
4

5 **IN THE MATTER OF** an application by
6 Facility Association for approval of revised
7 rates for its Newfoundland and Labrador
8 School Buses class of business.
9

10
11 **1. The Application**
12

13 Facility Association (“Facility”), as operator of the residual market mechanism for automobile
14 insurance in the Province, filed a Category 2 application on June 17, 2015 seeking approval of
15 increased rates for its Newfoundland and Labrador School Buses class of business (the
16 “Application”). Facility has not applied for rate changes for its School Buses class of business
17 since 1993.
18

19 In the Application Facility presents its rate level need using three sets of assumptions for cost of
20 capital and return on investment¹. Facility proposes an overall rate change of +13.9% based on
21 its indication using 0% cost of capital and 2.80% return on investment as follows:

Coverage	Facility Indication	Facility Proposal
Third Party Liability	+25.2%	+25.2%
Accident Benefits	+5.4%	+5.4%
Uninsured Automobile	+75.7%	+75.7%
Collision	-3.6%	-3.6%
Comprehensive	-3.1%	-3.1%
Specified Perils	-3.1%	-3.1%
All Perils	-3.4%	-3.4%
Total	+13.9%	+13.9%

¹ Facility presents its rate level indications based on the following assumptions:

- i) 12% cost of capital and 0.41% return on investment;
- ii) 0% cost of capital and 0.41% return on investment; and,
- iii) 0% cost of capital and 2.80% return on investment.

1 Approved rates are proposed to be effective no earlier than 100 days post-approval for both New
2 Business and Renewals.

3 4 **2. Application Review**

5
6 The Application was referred to the Board's actuarial consultants, Oliver Wyman Limited
7 ("Oliver Wyman"), for review. On September 2, 2015 the Board extended the 90-day review
8 timeline. On September 10, 2015 Oliver Wyman filed a report outlining its review of the
9 actuarial justification provided in the Application. Facility filed comments in response to the
10 Oliver Wyman report on September 24, 2015.

11 12 **3. Board Findings**

13
14 The Board is cognizant that there are a wide range of possible outcomes in any prospective
15 ratemaking exercise. The Board must be satisfied that the proposed rate changes are supported
16 based on the information filed and are not too high in the circumstance. In making this
17 determination the Board looks to the professional judgement of the actuaries, as well as the
18 support and explanation for their respective positions. The Board notes that neither Facility nor
19 Oliver Wyman took the position that each other's work was unreasonable or contrary to actuarial
20 practice standards.

21
22 The Board has reviewed the record of the proceeding, including Facility's Actuarial
23 Memorandum, Oliver Wyman's report on its review of the Application, and Facility's responses
24 to Oliver Wyman's report and the information requests. The issues to be addressed, as identified
25 in the report of Oliver Wyman, are: i) the loss trend rates; and ii) the full credibility standards.
26 These issues, along with the Board's findings on each, are discussed in the following sections.
27 The assumptions and methods used for all other parameters were found to be reasonable.

28 29 **3.1 Loss Trend Rates**

30
31 Loss trend rates are applied to the experience period incurred losses to adjust for the cost levels
32 that are anticipated during the policy period covered by the proposed rates. The selection of the
33 appropriate loss trend rate by coverage is a matter of actuarial judgment in the statistical analysis
34 of the underlying data. Because the industry experience for School Buses is too limited for use in
35 selecting loss trends Facility selects loss trend rates based on its analysis of NL Industry
36 Commercial Vehicles loss experience. This approach was also used by Facility in previous rate
37 filings to the Board for its Taxis and Limousines ("Taxis") class of business. Oliver Wyman
38 finds Facility's use of Commercial Vehicle loss experience to be reasonable.

39
40 In its 2014 Taxis filing Facility proposed alternate loss trends in place of the Board's guideline
41 trends approved for use at the time. In Order No. A.I. 11(2015) the Board found that Facility had
42 not justified its loss trend rate selections. Of particular concern was a change in Facility's loss
43 trend analysis methodology from its 2013 Taxis filing which resulted in trend selections being
44 premised on loss trend adjustments occurring around the 2004-H2 period without any support of
45 cause.²

² Order No. A.I. 11(2015), page 17.

1 In this Application Oliver Wyman notes that the underlying methodology used by Facility in its
 2 trend analysis is not changed from its 2014 Taxis filing and that the issues identified by the
 3 Board in Order No. A.I. 11(2015) continue to be present in the current analysis. In particular
 4 Oliver Wyman notes that Facility's trend selections are still premised on loss cost adjustments
 5 around the 2003/2004 period without any support of cause. Oliver Wyman states:

6
 7 *FA finds there to be statistical evidence that there was a change in cost level around the*
 8 *time of the Bodily Injury reforms introduced in August 2004 for every coverage. FA*
 9 *refers to this as a "scalar change," and calculates a scalar change for every coverage³*
 10 *within its loss trend regression models. The term "scalar change" is sometimes referred*
 11 *to as a "level change" and means that there was a one-time cost (frequency and/or*
 12 *severity) increase (or decrease), beyond what would be considered to be within the*
 13 *normal bounds of variability, and costs continued to stay at the new level, subject to the*
 14 *annual trend rate thereafter.⁴*

15
 16 Oliver Wyman further states:

17
 18 *Typically a "shift" in cost level is associated with some event such as a product reform,*
 19 *although in this case while FA's scalar changes are coincident with the 2004 Bodily*
 20 *Injury reforms, FA does not state that its scalar changes are attributed to the 2004*
 21 *reforms.⁵*

22
 23 Oliver Wyman does not agree that loss cost level changes occurred in the 2003 to 2004 period
 24 and finds that the year-to-year changes in the loss cost amounts from 2003 to 2004 are no more
 25 unusual than what occurred in other periods.⁶

26
 27 Facility has selected its loss trend rates based on its review of NL Commercial Vehicle data as of
 28 June 30, 2014. Oliver Wyman reviewed Facility's selections against the Board's published
 29 Commercial Vehicle guideline trend selections as of June 2014 and against the loss trend
 30 selections for December 2014, which became available during the course of the review of the
 31 filing. Based on its review Oliver Wyman found that Facility's selected loss trend rates were
 32 generally higher than the Board's June 2014 guideline loss trend selections and slightly higher
 33 than the trend rates selected by Oliver Wyman based on the December 2014 industry data. The
 34 alternate trend selections are shown below:

Loss Trend Rate Selections			
	Facility June 2014	Board Guideline June 2014	Oliver Wyman December 2014
Bodily Injury	+4.4%	+1.0%	+3.0%
Property Damage	+3.3%	+1.0%	+3.0%
Accident Benefits	+9.3%	+9.0%	+7.0%
Collision	+2.4%	-0.5%	+0.0%
Comprehensive	+1.8%	+0.5%	+1.5%

³ The exceptions to this are Uninsured Auto and Specified Perils.

⁴ Oliver Wyman Report, September 10, 2015, page 16.

⁵ Oliver Wyman Report, September 10, 2015, page 17.

⁶ Oliver Wyman Report, September 10, 2015, page 17.

1 Oliver Wyman states that the differences in the trend rate selections are generally due to different
2 judgements regarding: i) the trend measurement period; ii) the selected loss development factors;
3 iii) the inclusion/exclusion of loss adjustment expenses; iv) Facility's application of a level
4 change adjustment in the 2003/2004 time period; and v) a difference in the data valuation date.
5 Oliver Wyman suggests that the loss trend rates based on more recent data through December
6 2014 should be considered by the Board in reviewing the Application. Oliver Wyman states that,
7 given the uncertainty and volatility of the underlying loss experience, Facility's selected loss cost
8 trends are not unreasonable.

9
10 The Board notes that in the Application Facility has used a similar approach to its loss trend rate
11 selections as in its 2014 Taxis filing by including lost trend adjustments without any support of
12 cause. The Board has previously identified concerns with the loss trend adjustment used by
13 Facility which have not been addressed in the evidence.

14
15 The Board acknowledges Oliver Wyman suggestion that it consider the December 2014 NL
16 Commercial Vehicle data given that the trends selected by Facility are so close to Oliver
17 Wyman's selected loss trends based on the data available at that time. However, the Board notes
18 that, in accordance with the Board's Filing Guidelines, Facility's filing is based on the most
19 recent data available at the time of filing, which in this case is the data as of June 2014. While
20 the Board acknowledges that updated loss trend selections became available during the review of
21 the filing, it is the Board's position that the filing should be reviewed against the June 2014 NL
22 Commercial Vehicle data, the basis of the original filing.

23
24 The Board notes Oliver Wyman's opinion that Facility's selections are not unreasonable given
25 the uncertainty and volatility of the underlying experience but, in the circumstances, finds that
26 Facility has not justified its selection of alternate loss trend rates in place of the Board's
27 guideline loss trend rates.

28
29 **The Board finds that Facility has not justified the proposed selected loss trend rates.**

30 31 **3.2 Full Credibility Standards**

32
33 The standard of full credibility determines the weight given to Facility's School Bus experience
34 in the rate change indication. In this Application Facility proposes to lower its full credibility
35 standards which results in an increase in rate level indications of approximately 2.5%.

36
37 In rate filings prior to 2014 Facility's full credibility claim standards were selected with
38 reference to a study completed in 2004 by Facility's former external actuarial services provider
39 using 2003 Atlantic Commercial Vehicle data. This approach was accepted by the Board. In its
40 2014 Taxis filing Facility proposed to reduce its full credibility standards based on an internal
41 actuarial judgment decision to harmonize the credibility standards to be consistent at the
42 coverage level across all jurisdictions. This reduction gives more weight to actual experience
43 and, in certain circumstances, results in rate increases.⁷ In Order No. A.I. 11(2015) the Board
44 found that Facility had not provided sufficient actuarial support for its proposed change to the
45 full credibility standard.

⁷ Facility's Response to Oliver Wyman's Report, September 24, 2015, page 4.

1 In this Application Facility proposes to use the same credibility standards which the Board did
2 not approve in Order No. A.I. 11(2015). Oliver Wyman notes that Facility has not provided
3 additional technical support for the proposed change beyond what was provided in the 2014
4 Taxis filing. As part of its review Oliver Wyman updated the data used in the external 2003
5 Atlantic Commercial Study to include results for accident years 2009, 2010 and 2011. Based on
6 this analysis Oliver Wyman concluded that Facility's selection of full credibility standards in its
7 filings prior to 2014 continue to be supported.

8
9 In its response Facility does not agree with Oliver Wyman's contention that additional technical
10 support for a change in the full credibility standards was not provided in this filing. Facility
11 reiterated its position that reducing the full credibility standard provides an appropriate and
12 reasonable balance between Facility's actual experience and the complement of credibility.

13
14 The Board believes there is value in taking a consistent approach from filing to filing and that
15 any proposed changes that result in rate increases must be properly explained and supported. The
16 Board also accepts that the selection of a full credibility standard is a matter of actuarial
17 judgment. In Order No. A.I. 11(2015) the Board found that Facility had not adequately justified a
18 change to its full credibility standards for Newfoundland and Labrador. In this filing Facility
19 proposes to use the same credibility standards as denied in Order No. A.I. 11(2015), but has not
20 provided any additional actuarial support or justification to demonstrate that the rate increase
21 resulting from the change will not result in rates which are too high. In the absence of
22 justification to support the proposed change the Board will not accept Facility's proposed full
23 credibility standards.

24
25 **The Board finds that Facility has not justified the proposed change to the standard of full**
26 **credibility.**

27 28 **3.3 Conclusion**

29
30 The Board finds that Facility has not justified its proposals in relation to:

- 31 i) the loss trend rates; and
32 ii) the full credibility standards.

33
34 Facility's proposals result in an average overall rate level increase for all coverages combined of
35 13.9%. The Board notes that Oliver Wyman calculated an indicated increase of +6.8%⁸ using the
36 Board's June 2014 Commercial Vehicle loss trend rates and the credibility assumptions accepted
37 by the Board in Order No. A.I. 11(2015). The Board finds that the rates proposed by Facility are
38 too high in the circumstances.

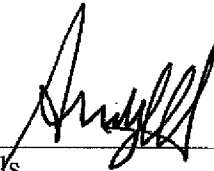
39
40 Based on the Oliver Wyman indications the Board accepts that a rate increase for Facility's
41 School Buses class of business may be justified. Facility may file a revised application with
42 further justification for its assumptions or, alternatively, substitute the indications provided by
43 Oliver Wyman using the Board's guideline selections and findings as discussed above.

⁸ Oliver Wyman Report, September 10, 2015, page 12.

1 **IT IS THEREFORE ORDERED THAT:**
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- 3 1. The Application by Facility Association is denied.
4
5 2. Facility Association will pay all costs of the Board, including the cost of the actuarial
6 review, arising from this Application.

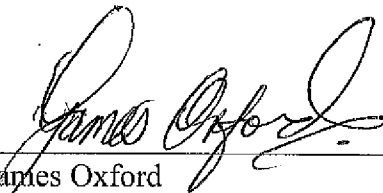
DATED at St. John's, Newfoundland and Labrador, this 29th day of January 2016.



Andy Wells
Chair & Chief Executive Officer



Darlene Whalen, P.Eng.
Vice-Chair



James Oxford
Commissioner



Cheryl Blundon
Board Secretary