

1 **A. I. 2(2007)**

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4 **IN THE MATTER OF THE *Automobile,***  
5 *Insurance Act*, RSNL 1990, c. A-22, as  
6 amended (the “*Act*”)  
7

8 **AND**

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

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17 On January 5, 2007 the Board received the Applicant’s rate filing dated December 22, 2006  
18 requesting approval of a revised private passenger automobile insurance rating program for use  
19 with effect from March 12, 2007 for new business and May 9, 2007 for renewal business.  
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21 **Legislation**

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23 On August 1, 2005 the Government of Newfoundland and Labrador enacted legislation  
24 amending the *Automobile Insurance Act* and the *Insurance Companies Act* in relation to the  
25 conduct of participants in the automobile insurance industry and the regulation of rates in the  
26 Province. Under the revised automobile insurance legislation, rate increases are subject to prior  
27 approval and the Board must prohibit or vary a proposed rate which is found to be “too high”.  
28

29 In determining if a rate is too high the Board considers the documentation available with respect  
30 to the justification of the rate levels including: i) the Applicant’s projected loss experience; ii)  
31 expenses; iii) investment income for the company’s automobile insurance business for the

1 province; and iv) other elements considered appropriate by the Board. Where the Board  
 2 determines that an insurer's loss experience is not relevant, inadequate or otherwise unreasonable  
 3 for use in establishing rates, the Board has discretion to establish the elements and information  
 4 upon which the insurer shall file its projected loss experience.

## 6 **Filing Instructions**

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 8 In the context of existing legislation the Board issued Filing Instructions and a Guidance  
 9 Document for use by insurers in connection with rate filings, hereinafter referred to as Filing  
 10 Guidelines. The Filing Guidelines detail the requirements respecting rate filings and provides  
 11 the following definitions of two types of filing categories:

### 13 **“3.1 CATEGORY - 1**

#### 15 **3.1.1 Category 1 - Definition**

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

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

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

### 30 **3.2 CATEGORY 2- GENERAL FILING**

#### 32 **3.2.1 Category 2 - Definition**

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

37  
 38 The Filing Guidelines include a Guidance Document, which sets out specific detailed direction  
 39 with respect to Category 2 filings. Specifically the Filing Guidelines state:

41 *“Insurers should have reference to the Category 2 Rate Application Guidance Document which is*  
 42 *attached to these Filing Guidelines as Appendix A. Insurers should note that this document sets*

1            *out guidance on completion requirements and various assumptions for such parameters as the*  
 2            *trend factor, loss development factors, credibility, ROE, ROI and premium to surplus ratio. To*  
 3            *the extent that insurers vary from the Category 2 Rate Application Guidance Document they will*  
 4            *be required to provide complete justification for consideration by the Board. Insurers should*  
 5            *note that the Board may have reference to advice from its consultants or may hold a hearing to*  
 6            *consider these proposals.”*  
 7

8            While an Applicant may utilize factors at variance with those set out in the Filing Guidelines, it  
 9            is required to provide sufficient evidence for the Board to assess these factors. It is in the context  
 10           of the foregoing that this filing is reviewed.

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 12           **The Application**

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 14           The current filing is the Applicant’s second Category 2 rate filing. The previous filing was made  
 15           on September 12, 2005. The Applicant now proposes a schedule of rates based on a Return on  
 16           Equity (ROE) of 10%, a Return on Investment (ROI) of 4.42%, and a Premium to Surplus Ratio  
 17           of 2.25:1. These parameters, as well as the assumptions made by the Applicant in connection  
 18           with other factors considered in the rate making process, are reflected in the indications and the  
 19           proposed rate changes shown below. The company’s indications are based on actuarial analysis  
 20           of the data and the assumptions made in the modeling exercise and represent the pure changes in  
 21           rates derived therefore. While the proposed changes in this case mirror the indications, these  
 22           could vary if the company chose to seek more than or less than the actuarially indicated rate  
 23           change.  
 24

<b>Coverage</b>	<b>Company Indications</b>	<b>Company Proposal</b>
Third Party Liability	-1.4%	-1.4%
Accident Benefits	-15.2%	-15.2%
Collision	8.9%	8.9%
Comprehensive	3.2%	3.2%
Specified Perils	24.6%	24.6%
Uninsured Motorist	-10.5%	-10.5%
Underinsured Motorist	-	-
<b>Total</b>	<b>-0.4%</b>	<b>-0.4%</b>

1 The Applicant proposes to offer the following discounts:

Discounts	%	Coverages
Years Licensed	13% - 16%	Third Party; Collision - Classes 01,02,03,07 and 15
Multi Vehicle	15%	Third Party; Collision, All Perils, Comprehensive and Specified Perils - Classes 01,02,03,07 and 15
Multi Product	10%	Third Party; Collision, All Perils, Comprehensive and Specified Perils
Student	50%	Third Party; Collision - Class 05

10 The Applicant proposes no changes to the previously approved Class of Use definitions.

### 12 **Detailed Analysis**

14 A copy of the filing was forwarded to the Board's actuarial consultants, Mercer Oliver Wyman (MOW) for their review and report. MOW reviewed the filing and, where necessary, issued information requests and received responses. On February 21, 2007 MOW completed its review and issued its report revised February 26, 2007 for minor changes, which identified two issues and provided alternate rate indications.

20 MOW reviewed the assumptions made by the Applicant and expressed the opinion that the majority of the assumptions were reasonably supported. MOW identified an apparent error in the Applicant's provision for reinsurance expenses associated with industry data. MOW noted that the Applicant uses industry data to attain full credibility for its loss data. The company's portion of the loss data is net of reinsurance expenses of 2.5% while the industry data is not. In order to bring the data to the same point, MOW removed the 2.5% expense provision for the industry data.

28 MOW also reviewed the Underwriting Profit Margin used in the filing but as this is not an actuarial issue MOW did not comment on the reasonableness of the request. MOW did provide alternate rate indications which are based on the profit margin which is set out in the Board's Filing Guidelines. The Board's Filing Guidelines notify insurers that an ROE of 10% and an ROI of 5.4% - 7.04% are acceptable for rate determination and that alternate ROE/ROI figures may

1 be used provided sufficient cost of capital evidence is provided with the filing in support of the  
 2 alternates. This approach allows a company to elect to make a rate filing without the expense and  
 3 burden of a detailed cost of capital review.

4  
 5 The Applicant elected to use the Filing Guideline target ROE of 10% but a proposed lower ROI  
 6 of 4.42%. This amount is determined by the Applicant as, "...the figure budgeted for 2007...".

7  
 8 The impact of the removal of the 2.5% reinsurance expense and use of the Board's guideline  
 9 5.4% ROI are provided in detail in the MOW report and are summarized in the table below:

Coverage	Company Indications	Company Proposal	Mercer Indications
Third Party Liability	-1.4%	-1.4%	-6.0%
Accident Benefits	-15.2%	-15.2%	-18.9%
Collision	8.9%	8.9%	7.8%
Comprehensive	3.2%	3.2%	2.0%
Specified Perils	24.6%	24.6%	22.0%
Uninsured Motorist	-10.5%	-10.5%	-15.6%
Underinsured Motorist	-	-	-
Total	-0.4%	-0.4%	-4.2%

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 20 A copy of the MOW report was provided to the applicant on February 22, 2007 and the revised  
 21 report was provided on February 26, 2007.

### 22 23 **Revised Proposal**

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 25 Following review of the MOW report, on March 20, 2007 the Applicant provided additional  
 26 information and comment on the MOW findings along with a revised rate proposal as follows:  
 27

Coverage	Original Company Proposal	Mercer Indications	Revised Company Proposal
Third Party Liability	-1.4%	-6.0%	-2.5%
Accident Benefits	-15.2%	-18.9%	-16.4%
Collision	8.9%	7.8%	8.9%
Comprehensive	3.2%	2.0%	3.2%
Specified Perils	24.6%	22.0%	26.7%
Uninsured Motorist	-10.5%	-15.6%	-12.5%
Underinsured Motorist	-	-	-
Total	-0.4%	-4.2%	-1.2%

The Applicant does not dispute the MOW finding in respect to the reinsurance expense and states it will accept the Board's determination on the matter. In connection with the ROI the Applicant reiterates the manner in which the ROI was determined and advises it was based on an investment portfolio "similar" to that used in the previous review to arrive at the 4.76% rate accepted by the Board.

### **Board Findings**

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 the rates are "too high". This is consistent with the current legislation and is in keeping with the historical practice of the Board.

In accordance with the legislation and as set out in the Board's detailed Filing Guidelines the Applicant is required to provide detailed 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. In the case of the cost of capital issue this would generally include expert evidence and detailed financial information particular to the company and in relation to the markets in general.

1 The Board has reviewed the filing, the supporting material, responses to information requests,  
2 the consultants' report and all other information relevant to this rate filing. In relation to the  
3 proposed ROI of 4.42% the Applicant has not provided detailed cost of capital evidence in  
4 support of the proposed figure. The Applicant provided a statement that the proposed figure is  
5 the target ROI and has further provided a statement of the returns for the last three years. As  
6 clearly indicated in the Filing Guidelines and as set out in some detail in Order A.I. 11(2006)  
7 detailed cost of capital evidence must be filed in support of an application unless the filing  
8 guideline figures are proposed. The Board therefore will not approve the proposed ROI of  
9 4.42% as it has not been justified.

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11 In its previous Category 2 filing, the Applicant sought an ROI below 5.4%. At that time the  
12 Board's cost of capital consultants conducted a review and issued a report in connection with the  
13 Applicant's proposed ROI. For the reasons enumerated in Order A.I. 11(2006) the Board  
14 determined that the Applicant had supported an ROI of 4.76%. Given the relative short time  
15 since this approval and in the circumstances, most notably the relative stability of the parameters  
16 for establishing an appropriate ROI, the Board is satisfied that the 4.76% ROI continues to be  
17 appropriate and reasonable at this time. The Board will require the Applicant to revise the  
18 proposed rates to reflect an ROI of 4.76%.

19  
20 In relation to the reinsurance issue the Board notes that the Applicant has accepted the MOW  
21 approach and provided revised proposed rates on this basis. The Board will approve rates which  
22 reflect the removal of the 2.5% associated with the industry loss data reinsurance expense.

23  
24 The Board finds the proposed discount program is consistent with that previously approved and  
25 is reasonable and justified in the circumstances. The discounts relate to risk, are not subjective or  
26 arbitrary, and are in accordance with the legislative provisions. In addition, the impact of the  
27 discounts has been appropriately reflected in the rate filing.

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1 **Costs**

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3 As set out in the Filing Guidelines, 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 filing, including the costs of the actuarial review.

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7 **IT IS THEREFORE ORDERED THAT:**

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10 1. The proposed rates are prohibited.

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12 2. The Applicant shall file with the Board revised rate indications reflecting the findings of  
13 the Board which specifically include an ROI of 4.76%, and the removal of the 2.5%  
14 associated with the industry loss data reinsurance expense.

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16 3. The Applicant shall submit for the approval of the Board a revised rate proposal which  
17 for each coverage shall be no more than the indications filed with the Board, in  
18 accordance with this Order setting out the proposed effective dates for the rates to take  
19 effect.

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21 4. The proposed discount program is approved.

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

**DATED** at St. John's, Newfoundland and Labrador, this 5<sup>th</sup> day of April 2007.

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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