

DECISION

**NSUARB-INS-10-25
2010 NSUARB 157**

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE INSURANCE ACT

- and -

IN THE MATTER OF AN APPLICATION by **RBC GENERAL INSURANCE COMPANY** for approval to modify its current rates and risk-classification system for private passenger vehicles, including adoption of the 2009 CLEAR table as approved by the Board

BEFORE: Roberta J. Clarke, Q.C., Member

APPLICANT: **RBC GENERAL INSURANCE COMPANY**

FINAL SUBMISSIONS: July 6, 2010

DECISION DATE: **July 27, 2010**

DECISION: **Application is approved, as modified by the Board.**

I INTRODUCTION

[1] RBC General Insurance Company ("RBC" or the "Company") filed an application with the Nova Scotia Utility and Review Board (the "Board") for approval to modify its rates and risk classification system for private passenger vehicles. The supporting documents and materials (the "Application"), dated March 31, 2010 were filed electronically on April 1, 2010, and the hard copies were received on April 8, 2010.

[2] Information requests ("IRs") were sent to the Company on April 21, 2010, and responses were received on May 7, 2010. An additional IR was sent to the Company on May 11, 2010, and a response was received on June 1, 2010. Further information was requested on June 8, and June 16, 2010, and responses received on June 16, and June 17, 2010, respectively.

[3] As a result of a review by Board staff, a staff report, dated June 18, 2010, (the "Staff Report") was prepared. The Staff Report was provided to RBC for review on June 18, 2010. The Company responded with comments on the Staff Report on June 28, 2010. After reviewing the comments, Board staff sent a response to the Company's comments on June 28, 2010. Final comments were received from the Company on July 6, 2010.

[4] The Board did not deem it necessary to hold an oral hearing on the Application.

II ISSUE

[5] The issue in this Application is whether the proposed rates and changes to the risk-classification system are just and reasonable and in compliance with the *Insurance Act* (the "Act") and its *Regulations*.

III ANALYSIS

[6] The Company sought approval to change its rates and its risk-classification system for private passenger vehicles. The Application was made in accordance with the *Board's Rate Filing Requirements for Automobile Insurance - Prior Approval (including Mandatory Filing)* (the "*Rate Filing Requirements*"). The proposed effective dates are October 1, 2010, for new business, and November 15, 2010, for renewal business.

Rate Level Changes

[7] The Company proposed to change its rates and risk-classification system. The proposed change is a reduction of 0.1% for the total of all coverages, while the indications provided by RBC suggested that there should be a 0.5% decrease.

[8] A comparison of the proposed changes and the indicated changes revealed that with the exception of Specified Perils and the Family Protection Endorsement (Uninsured Motorist or "UM") ("SEF#44"), the proposed and indicated changes were identical. For Specified Perils, the proposed reduction was considerably less than the indicated change, and for SEF#44, the Company proposed no change where a

considerable reduction was indicated. As support for the proposed changes, RBC used data from its experience in Nova Scotia over the three accident years ending December 31, 2008.

[9] In considering the Company's Application, Board staff reviewed all aspects of the ratemaking procedure, including the following:

- Loss trends and the effects of reform
- Loss development
- Unallocated loss adjustment expense provisions
- Credibility standards and procedure
- Premium and rate group drift
- Expense provisions
- Experience period and weights
- Premium-to-surplus ratio
- Return on equity ("ROE").

[10] Board staff indicated that all of these aspects appeared reasonable, with the exceptions of the expense provisions, premium-to-surplus ratio, and ROE. In each of those instances, Board staff suggested alternate assumptions might be considered. A number of the IRs focused on these issues.

[11] The Company used a 2.2:1 premium-to-surplus ratio, which is lower than the 2.5:1 ratio used in its last filing with the Board. The Company states that because of the increased potential for volatility in results due to the small size of its book of business in Nova Scotia, more capital is required to support the risk. The Company also acknowledged that it had increased its internal target for the minimum capital test ("MCT") of the Office of the Superintendent of Financial Institutions ("OSFI"). With the need for

additional capital, the lowering of the premium-to-surplus ratio means more surplus is required for each premium dollar.

[12] At the same time, the Company is proposing to increase its target ROE from the current 11.5% to 18%. In its response to IR-9, RBC stated:

The change in target ROE from 11.5% to 18% is not solely driven by the increase in MCT ratio. It is driven by a combination of factors, as outlined in page 5.19 of the filing. Return on equity consists of two components, the return demanded by investors in order to invest in the business and the capital levels required to support the business. Given that RBC has increased the MCT ratio, the level of capital required to support the business has necessarily increased. Balancing that is the additional risk premium that investors require in order to provide higher levels of capital. For a province like Nova Scotia, the risk is greater since there can be significant fluctuation in the performance of the book due to its small volumes. Also, there has been much uncertainty in the political environment. Constitutional challenges abound in various provinces and specifically at this time for Nova Scotia there has been the increase in the cap for non-pecuniary damages, which introduces additional uncertainty in expected results. There are other uncertainties including premium instability, soft economy, insurance fraud and terrorist attacks. In the recent past (2004, 2005, 2006, 2007), the P&C insurance industry has achieved ROE's at this level and it is not unreasonable for investors to demand the same level of return on a go forward basis.

[13] The Company further provided its explanation for a higher capital requirement in response to IR-12:

There is a disproportionate amount of capital required to support the infrastructure for a relatively small book of business. Also, there is much uncertainty in the province as listed below.

- Premium instability: 39.8% increase in auto insurance premiums between April 2002 and April 2003.
- Soft Economy: economic downturn has meant lower returns in the stock market and increased solvency risk due to lack of funds
- Insurance Fraud: drastic increase in fraudulent claims and 26% of personal injury claims had "elements of fraud"
- Terrorist Attacks: a generalized climate of insecurity since September 11th, 2001.
- 2003 Auto Reform: introduction of \$2500 minor injury cap and mandated rate reduction of 20%
- Constitutional Challenge against the cap: announced minor injury cap increase to \$7500

[14] Not all of these factors can be said to apply to Nova Scotia alone; the Company said that these risks apply in all provinces. It did identify increased uncertainty resulting from court challenges and auto insurance reform in Nova Scotia as contributing to the need for higher capital.

[15] In its final comments to the Board, the Company suggested that Nova Scotia policyholders would "benefit from RBC's higher capital requirements in terms of secured payouts....and the confidence that RBC Insurance will remain solvent...".

[16] In other responses to the Board, the Company had noted both the expectations of its investors for continued high ROE, and its parent company's requirements, as reasons for the higher target ROE.

[17] Board staff had identified a concern that the higher target ROE and the lower premium-to-surplus ratio would result in RBC accounting for what it claims to be higher risk in two ways, essentially a sort of "double recovery".

[18] The Board is not satisfied that it is just and reasonable for the Company's clients to bear the cost of meeting the expectations of the Company's investors or parent company by allowing a target ROE of 18%. This is significantly higher than the target for past years as shown in the Application, and higher than most other companies who write similar business in Nova Scotia. The Board does acknowledge that there is some uncertainty and some higher degree of risk due to the small amount of business the Company writes in Nova Scotia; however, the Board finds that this can be accommodated by the change in the premium-to-surplus ratio proposed by the Company. Accordingly, the

Board is prepared to allow the Company to use the same targeted ROE of 11.5%, with a 2.2:1 ratio.

[19] With respect to expense provisions, the Application suggests that the average expense ratio is higher than industry, as reported by the Board's actuarial consultants, Oliver Wyman ("OW") in its April 27, 2010 report on the Cost Implications of Changes to the Minor Injury Regulations Nova Scotia. When asked to explain this, the Company responded in IR-4:

...In this filing, RBC incorporated the per car health levies into variable expenses. In past filings, the health levies were allocated to average premiums directly as dollar amounts. The expense provision under the new method would be higher as the variable expenses increase and the average premium decrease. ...

[20] RBC advised that its expenses would be less if the health levies were removed. OW indicates that the health levies are not included in the reported expense average, and therefore the Board is satisfied that the overall expense provision is reasonable in the circumstances.

[21] However, the Board notes that RBC allocates expenses differently by coverage. Internal acquisition costs and overhead costs are allocated only to the mandatory coverages, with no allocation of these costs to optional coverages. In response to IR-2 which questioned whether this created a cross-subsidization among coverages, RBC said that it:

...changed the allocation of internal acquisition costs and overhead in the last filing. The allocation to only mandatory coverages would provide a more accurate representation of the expenses incurred on each individual risk, since these expenses tend to vary with the exposure itself, not with any individual coverage. Therefore, this does not create a cross subsidization among the coverages.

[22] In its response to a review of the Staff Report, the Company said:

Our allocation of expenses to mandatory coverages are necessary since this aligns with our actual expenses. We must pay to cover certain fixed cost of writing a policy regardless of whether or not the insured opts for full coverage or mandatory coverage only. Therefore in our view it makes sense to allocate them to mandatory coverage so as to ensure full expense recovery and to prevent excessive recovery from clients purchasing optional coverages.

The approved expense percentages have been adjusted so that the total expense loading for all coverages combined is equivalent to the prior method. This does not represent an impact to the overall rate level, but rather is purely done to allocate costs in accordance with our experience. Similarly, this aligns the approach to pricing employed by RBC Insurance in other provinces.

[23] While the Board has some concern that the total allocation of these expenses to mandatory coverages has potential for cross-subsidization, the Board is prepared to allow this allocation as it will not change the overall results.

[24] The Board requested the Company to provide it with indications, and proposed changes, using the expense allocation assumptions in place, and with the lower premium-to-surplus ratio, and target ROE of 11.5%. The results were provided to the Board as an attachment to an email dated July 6, 2010 and show that the overall indicated rate change is a decrease of 7.34%, with the Company proposing an overall rate decrease of 6.97%. Again, the differences arise from the Company making no change in UM or SEF#44 coverage, and a smaller reduction in Specified Perils. The Company advised that it has little data from those coverages, and as a result there is insufficient evidence on which it would be prepared to adjust its rates to the indicated rates.

[25] The Board is satisfied that the rates proposed in the July 6, 2010 communication from the Company are just and reasonable, and is prepared to accept them.

Territorial Changes

[26] As part of the Application, RBC undertook the required analysis of its territorial differentials. It developed indicated average premiums by territory for each coverage, and generally followed its indications.

[27] The Board is satisfied that the selections for the Company's territorial differentials have been adequately supported.

Gender Differentials

[28] RBC recognizes gender in its rates by using a driver experience discount. For drivers with less than 9 years of experience, the discount differs between males and females.

[29] The Company chose to make no changes to the discount structure at this time, citing a lack of credibility in the limited data.

[30] The Board is satisfied that this is appropriate.

Web Based Discount

[31] RBC presently offers a discount when an insurance quote is obtained from its website, as a result of expense savings. The Company proposes to extend this discount to quotes that come from a third party website, since there will be expense savings when the quote is transferred from the third party website to the Company's internal system.

[32] The Board finds that such a change to the discount is just and reasonable.

2009 CLEAR Table

[33] RBC proposes to adopt the 2009 CLEAR table, as approved by the Board, using the Collision and Comprehensive rate groups proposed by the Vehicle Information Centre of Canada, and the 2008 CLEAR table rate groups for Accident Benefits.

[34] Since the actuarial analysis included premium drift as part of the indications, RBC has complied with the Board's requirements to adopt the approved table. As a result, the Board approves this change as just and reasonable.

Rate Manual Review

[35] The Company proposed no changes to its rate manual, other than the adoption of the CLEAR table as noted, and the changed rates themselves. A review by Board staff determined that there are no instances where the Company is in violation of the *Regulations*.

IV FINDINGS

[36] The Board finds that the Application complies with the *Act* and *Regulations*.

[37] As the Application included full actuarial indications and the required territorial and gender analysis, it qualifies to set the new mandatory filing date for private passenger vehicles for RBC to April 1, 2012.

[38] Based upon the evidence before it, the Board is satisfied that the changes in rates resulting from the Board's direction to use the 2.2:1 premium-to-surplus ratio and the allocation of expenses as proposed, and the lower target ROE of 11.5% will not jeopardize the financial solvency of the Company. The rates that result from the changes so directed are just and reasonable and they are hereby approved.

[39] The Board approves the adoption of the CLEAR table as outlined above, and the proposed change to the Web Based Discount.

[40] The Board approves the effective dates of October 1, 2010, for new business, and November 15, 2010, for renewal business.

[41] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 27th day of July, 2010.

Roberta J. Clarke