# Saskatchewan Rate Review Panel

# Report to the Minister Responsible for Crown Investments Corporation of Saskatchewan

**regarding**

# Saskatchewan Auto Fund Rate Application Effective date August 31, 2014

**Report submitted June 11, 2014**

## Introduction

The Panel believes this Application was affected by the 2013 Application and the events that occurred during that review. The strong and immediate reaction from the motorcycle community led to a government directive to include motorcycle rates under the proposed 15% rate cap, and also to the creation of a Motorcycle Review Committee, which has been exploring various motorcycle licensing and safety measures.

The 2013 rate proposal also brought further criticism from the Taxi industry, which made presentations during previous reviews that were critical of SAF's policies affecting the industry, and in particular, the Business Recognition program. The Panel notes that SAF launched consultations with the Taxi industry in December 2013, and SAF is exploring various measures to address the issues that affect the taxi industry.

The Panel welcomes these developments and commends SAF for its constructive engagement with these stakeholder groups in particular, and for its commitment to fulfill its mandate on behalf of all of its customers.

With these factors in mind, the Panel undertook its review of the Application to fulfill its mandate to ensure fairness and rate stability for all vehicle owners.

### The Rate Proposal

The Auto Fund rate proposal includes an average 2.7% increase to cover its operating expenses and liabilities, and a 3.7% capital amount on top of the rate charge to help replenish the Rate Stabilization Reserve. The Auto Fund proposed that rate increases for all vehicle classes would be rebalanced and capped, with the exception of motorcycles.

### The Terms of Reference

As one part of its Terms of Reference, the Panel is to consider the reasonableness of the rate proposal in the context of:

> *"the objective of ensuring stability and fairness in vehicle insurance rating such that each vehicle class pays sufficient premiums to cover its anticipated claim costs to minimize cross subsidization."*

The operating philosophy of the Saskatchewan Auto Fund is that it will break even over time, recording neither a profit nor a loss. As stated in the Minister's Terms of Reference for this review, the Auto Fund's mandate is "*… to operate on a self-sustaining basis over time.*"

### Fairness in Setting Rates

The Panel, seeking to ensure fairness and stability in rates, evaluated the Auto Fund's proposal for a 2.7% average rate for all vehicle classes, with rebalancing for all vehicle classes, except motorcycles that would see a flat rate increase of 2.7% with no rebalancing. This differs from what SAF states is the actual indicated rate need for all vehicle rate classes, including motorcycles, of 3.4%. SAF's proposal would result in a shortfall in the motorcycle class of $6.8 million, which SAF states would be funded by the Rate Stabilization Reserve (RSR). In effect, with this proposal, SAF is budgeting for a loss, which is at odds with its mandate of operating on a self-sustaining basis over time.

The proposal to fund the shortfall in the motorcycle class from the RSR is at cross-purposes with another significant component of the rate proposal, where SAF proposes an additional 3.7% increase (the capital amount) to be applied to all vehicles, including motorcycles, to help replenish the RSR; this is taking place at the same time SAF proposes to withdraw $6.8 million from the RSR to subsidize one rate class, essentially to cover the budgeted shortfall in its rate request. In their report the Consultants observe that this action *"… would be expected to diminish the effectiveness of the capital build provision being proposed, and otherwise increase the needed capital build provision for the next Application."*[1]

**Fairness in Replenishing the Rate Stabilization Reserve**

The purpose of the Rate Stabilization Reserve (RSR) is to protect customers from unexpected or catastrophic claims costs and to moderate the need for large rate increases, which could lead to rate shock. The Auto Fund calculated the proposed increase in the capital amount based on an industry measure called the Minimum Capital Test, which tests the adequacy of funds in the RSR, setting the target at 100% under its recently revised Capital Management Policy. Since the RSR is currently below the 100% MCT target ratio, the Auto Fund proposes to replenish the RSR over a five-year period, beginning with the increase in the capital amount in this rate Application.

The Panel is concerned about the influences of the calculations used to determine the capital amount, which have a direct effect on the amount charged to customers. SAF chose 100% as the appropriate Minimum Capital Test ratio, and selected an adverse one-in-100-year event (99th percentile event) as the most appropriate among a variety of adverse scenarios that could negatively affect the RSR. A reduction in adverse scenario percentile levels from 99th percentile to 97.5 percentile would result in a reduction of approximately $42 million in the MCT target dollar level of the RSR at December 31, 2013. The different scenarios tested indicate that an MCT target ratio between 88% and 91.5% might be more appropriate, resulting in a decrease of approximately $28 million to the MCT target level of the RSR at that date.[2] Rounding up to 100% represents an increase of approximately 10% over the indicated ratio using other adverse scenarios, perhaps reflecting excessive conservatism by SAF. These two changes would result in an approximate reduction of $70 million in the MCT target dollar level of the RSR at that date, indicating the need for a reduction in the capital amount proposed by SAF.

Rounding up the selected MCT target ratio to 100% also raises the question of intergenerational equity, since contributions made to the RSR by today's customers could be used to cover adverse events to the benefit of future customers.

---

[1] Independent Technical Report, P. 19
[2] Independent Technical Report, P. 33

The Panel is also concerned that the proposed capital replenishment of 3.7%, which is a major component of the premium that customers would see on their bills, would continue to be charged until the Auto Fund made a specific Application to discontinue it.

**Fairness in Rate Rebalancing, Capping and Rate Stability**

The Panel gave careful consideration to the proposals for rate rebalancing and capping in this Application. The Panel noted that with the implementation of the 2013 rate changes, 94.6% of all vehicles were paying a rate that is within 5% of their indicated adequate rate. This demonstrates that the Auto Fund has made great strides in moving toward fair rates for its customers through somewhat aggressive rebalancing in previous Applications. If the 2014 Application were to be approved as filed, 97.8% of all vehicles would be within 5% of their indicated rate.

The Panel believes it is time to provide some relief to customers at or near the top end of the proposed capping program, which includes set dollar amounts for premiums less than $1000 and 15% on premiums over $1000. If this Application was approved as filed, some customers could pay premium increases of more than 18% (a 15% maximum cap + 3.7% capital amount), which could be considered rate shock.

The Panel, in its deliberations, addressed the issue of fairness and stability with regard to the proposal to exclude motorcycles from rate rebalancing. The Panel has two main concerns with this proposal: First, SAF has an expectation that the measures implemented as a result of the Motorcycle Review Committee may result in a 20% drop in claims costs.[3] Even if these benefits were immediately evident, this favourable outcome would still leave a gap of about 26% between revenues and costs in the motorcycle class, since the current indicated rate need is 46.8%. Second, the decision to exclude motorcycles from rate rebalancing is open-ended, with no indication when rebalancing would resume. As the Consultants note, "*… to freeze rebalancing for the Motorcycle class without determining when the 'thaw' will occur questions the principle of fairness relative to all other vehicle classes.*"[4]

Since the purpose of rate rebalancing is to minimize cross-subsidization among all vehicle classes, the Panel questions if the proposal is the most reasonable solution to ensure fairness and rate stability for all vehicle classes.

[3] Response to second round Information Request # 16
[4] Independent Technical Report, page 40.

## Executive Summary

The SGI Saskatchewan Auto Fund submitted its rate request on February 4, 2014. The Minister's Order and Terms of Reference are attached as Appendix A. The Application is attached as Appendix B.

An Order from the Minister of Crown Corporations (the Minister) instructed the Panel to review the Application and submit its report by June 11, 2014.

The rate proposal presented to the Panel would take effect August 31, 2014. It includes:

- A 2.7% average increase, with rate rebalancing and for all vehicles, with the exception of motorcycles;
- A 2.7% flat rate increase for motorcycles with no rebalancing; and
- An additional 3.7% increase on all vehicles to help replenish the Rate Stabilization Reserve. This capital amount would be applied to the rebalanced rate for each vehicle and the flat rate applied to each motorcycle.

The Auto Fund states that because there is currently a 1.23% RSR surcharge built into the rates until August 30, 2014, the average increase for customers over their current rates would be 5.2%.

It also says the primary reason for the requested 2.7% average increase is an agreement that provides 10% increases in auto body shop labour rates in each of 2014, 2015 and 2016. The last previous increase in body shop labour rates was a 2% increase in 2011.

The SAF also points out that the major cost driver for motorcycle rates is injury claims costs, which account for 73% of all costs in the motorcycle class (unlike CLEAR-rated vehicles where injury makes up approximately 25% of the total required premium), which in large part drives the need for the indicated rate need of 46.8% in the motorcycle class.

During the review period, the Panel reviewed the Application, supporting documents and supplementary information, and an independent technical report from its Consultants. The Consultants' report is attached as Appendix C. This information can be found on the Panel's website at www.saskratereview.ca. The Panel also encouraged and responded to public input through a variety of channels including public meetings, email, mail, website, phone, Facebook and Twitter.

## Public Consultations

This Application did not generate the same level of public comment as did the 2013 Application, but it did again draw considerable comment from individual members of the motorcycle community, and from organizations such as Riders Against Government Exploitation (R.A.G.E.). The public meeting in Regina included a presentation and alternative rate proposal by Don Fuller on behalf of R.A.G.E., and two presentations by individuals. Fourteen individuals participated in the question-and-answer session that followed. At the public meeting in Saskatoon six individuals made presentations and seven individuals participated in the question and answer session. The Panel also received more than 180 comments or questions by email, voice mail, and through the Panel's website.

## Recommendations

As noted in the Introduction, the Panel has concerns regarding the fairness and equity of the rate proposal in this Application. The Application contains two rate components: a proposed 2.7% increase in revenue to cover the Auto Fund's operations, with rebalancing and capping applied to all vehicle classes except motorcycles, and a proposed 3.7% increase in the capital margin (approximately 2.5% over the current 1.23% RSR surcharge) to help replenish the Rate Stabilization Reserve, for a total increase of 6.4%. This represents an average increase of 5.2% over current rates. After a thorough analysis of the Application and supporting documents, the independent technical report from its Consultants, and input from the public, the Panel makes the following recommendations:

### General Rate Increase

The Panel accepts the Auto Fund's estimate that it requires an overall average increase of 3.4% in the general rate to cover its expected operating expenses.[5] The Panel notes that SAF's rate Application requests a 2.7% increase, with motorcycles excluded from the rate rebalancing and capping that is to be applied to all other vehicle classes. SAF also proposes to fund a $6.8 million shortfall in the motorcycle class by taking funds from the Rate Stabilization Reserve (a savings account intended to cover emergencies and protect customers from rate shock). The Panel does not agree with these proposals for three reasons:

1. It implies that SAF is budgeting for an operating loss, which is contrary to its basic operating philosophy and inconsistent with the Minister's Terms of Reference that the Auto Fund's mandate is to "operate on a self-sustaining basis over time."

2. Using Rate Stabilization Reserve funds for one class at the expense of the others, does not meet the test of "fairness and rate stability for all vehicles", and lowers the level of funds in the RSR, requiring larger premiums now and later to make up the difference.

3. It creates a situation where the motorcycle class falls further behind in comparison to the other vehicle classes. While the Panel welcomes the safety measures and more stringent licensing initiatives put forward by the Motorcycle Review Committee, it is of the view that it will take some time before the results of these changes will have a significant impact on claims cost trends.

The Panel accepts SAF's 2014 cost allocation methodologies and results, and that on balance, SAF's OM&A costs presented are reasonable. However, the Panel encourages SAF to seek out further efficiencies in its operations and urges SAF to be more vigilant in its budgeting.

[5] Saskatchewan Auto Fund 2014 Rate Proposal, P. 4

After considering all aspects of the general rate increase, including accepting SAF's estimate that it requires a 3.4% overall rate increase to break even, and concurring with its Consultants that giving special treatment to motorcycles fails to meet the test of being just and reasonable, and considering the need to treat all customers fairly, the Panel recommends to the Minister:

> **that the overall general rate increase (before the capital amount) be 3.4%, to take effect August 31, 2014.**

Refer to Section 4.1 of this Report for a complete commentary on this Recommendation.

**Rate Rebalancing and Rate Capping**

This Application proposes that vehicle rates be rebalanced to bring them closer to their indicated rate, but with rate capping to mitigate the potential for rate shock. The exception to rebalancing and capping would be the motorcycle class. Under the proposal, premiums above $1000 would be capped at 15%, while premiums below that threshold would be at set dollar amounts.

After careful consideration of the issues involved, the Panel agreed with the recommendation from its Consultants that motorcycles be included in rate rebalancing and capping, since ensuring stability and fairness in vehicle insurance rating involves minimizing cross-subsidization among vehicle classes. The Consultants observe that, *"As such the proposed treatment specifically for the motorcycle class will not, in its current form, meet that objective."*[6]

The Panel also shared its Consultants' concerns that the proposal to exclude motorcycles from rebalancing does not suggest at what point rebalancing might resume: *"… to freeze rebalancing for the motorcycle class without determining when the 'thaw' will occur questions the principle of fairness relative to all other vehicle classes."* [7] The Consultants further note that the proposed freeze places an additional burden on other vehicle owners for an indefinite period of time: *"… the issue is not so much what should be the recommendation for this year's Application, but more so what principles are going to be the foundation for proposed rate changes for the motorcycle class in this and subsequent Applications. To provide the relief proposed in this Application for the Motorcycle class, an additional burden has still been placed on other ratepayers."*[8]

Recognizing that rebalancing and capping approved in previous Applications has brought almost 95% of all vehicles within 5% of their indicated rate, and that Saskatchewan people are facing price increases in many areas, the Panel investigated the effects of capping rates at two-thirds of the proposed capping program.

Because of the large rate need in the motorcycle class (an indicated 46.8% rate requirement), most would experience rate increases at or near the cap. Under this reduced capping level, the highest full-year premium increase for any motorcycle would be $323.[9] Since many motorcycles

---

[6] Independent Technical Report, P. 40
[7] Ibid., P. 40
[8] Ibid., P. 40
[9] Responses to first round Information Request # 14 and second round Information Request # 14

would be licensed for six months or less, this would cut the dollar amount of the increase by at least half, or $160 or less.

Recognizing the need to be fair to all Auto Fund customers, and believing this is an appropriate time to moderate large rate increases, the Panel recommends to the Minister:

**that all vehicle classes be included in rate rebalancing, and**

**that rate capping be set at a maximum 10% on premiums over $1000, and at two-thirds of the proposed rate cap in dollar amounts on premiums less than $1000.**

Refer to Section 4.2 of this Report for a complete commentary on these Recommendations.

**Capital Amount**

The Terms of Reference for this review ask the Panel to consider the reasonableness of the proposed rate changes in the context of maintaining adequate capital in the Rate Stabilization Reserve (RSR) to serve as a cushion to protect customers from large increases within the terms of the Capital Management Policy approved by the SGI Board.

In this Application, SAF proposed a 3.7% increase to all vehicles to help replenish the RSR. SAF stated that this capital amount would move the level of the RSR one-fifth of the way toward the MCT target ratio of 100%, which is set under the current Capital Management Policy.

The selection of an appropriate MCT target ratio is based on modeling of the effects of adverse scenarios on the RSR. Notwithstanding that the results of two modeling scenarios were between 88% and 91.5%, SAF rounded up the analysis to a 100% target ratio. The Consultants found after examining these scenarios that the selection of 100% as the appropriate MCT target ratio might be a sign of excessive conservatism by SAF. The Consultants suggest a ratio between 88% and 91.5% might be more appropriate. The difference between 100% and the foregoing results is significant in dollar terms, representing a reduction of approximately $28 million to the MCT target dollar level in the RSR as at December 31, 2013.

The Consultants also considered the question of the appropriate adverse scenario percentile level for a Crown corporation monopoly providing basic insurance coverage. A rough estimation of the reduction in the MCT target ratio due to changing from a 99$^{th}$ to a 97.5 percentile outcome level would be about 15 percentage points, which would represent a reduction of approximately $42 million to the target dollar level of the RSR at December 31, 2013.

The impact of these two changes in total would be approximately $70 million in the calculation of the RSR target dollar level at December 31, 2013, which suggests the proposed MCT target ratio is overly conservative and a reduction in the amount of the proposed capital margin may be warranted.

The Panel notes that the proposal to replenish the RSR over a 5-year period would actually impact customers most significantly in the first year, in part because the remaining difference between the current and target MCT ratios would be spread over another five-year period with each new rate Application. Since the purpose of the RSR is to mitigate rate shock, the Panel urges that SAF amend its Capital Management Policy to limit the change in the capital amount from one Application to the next to one percentage point (+ or -), to avoid adding to rate shock when replenishing or releasing amounts from the RSR.

The Panel notes that the 1.23% RSR surcharge included in the current rate would expire on August 30, 2014, and with its continuation as part of the capital amount, the net effect of the capital amount (3.7%) proposed by SAF on current rates would be an increase of approximately 2.5% over and above the general rate increase.

After careful consideration of all of the information, the Panel recommends to the Minister:

> **that a total capital amount of 2.23% be approved, to take effect August 31, 2014, which is one percentage point greater than the 1.23% Rate Stabilization Reserve surcharge in the current rate.**

And the Panel further recommends:

> **that SAF bring forward rate adjustments based on the Capital Management Policy annually, regardless of whether there is a rate Application, so that the capital amount embedded in rates can be recalibrated to reflect changes in circumstances over the year. These rate adjustments could be contained in a confirmation submission to the Saskatchewan Rate Review Panel, which would verify the change to the Rate Stabilization Reserve.**

> **that SAF include as part of the Minimum Filing Requirements in future Applications discussion regarding any recent, pending or proposed changes to the Minimum Capital Test, and how these have affected or may affect recent or forecasted Minimum Capital Test ratios and the Capital Management Policy.**

Refer to Section 4.3 of this Report for a complete commentary on these Recommendations.

### Traffic Safety

The Panel notes that over the past several years, spending on Traffic Safety programs overall have been below budget estimates. While the Panel acknowledges that SAF does not have control over some of the Traffic Safety initiatives that it is required to fund, or the timing for some initiatives where it works with external partners, the Panel notes that when funds for Traffic Safety programs are not spent, vehicle owners are paying through their rates for safety programming that has not been implemented. Accordingly, the Panel recommends:

> **that the Auto Fund track and report budget and actual Traffic Safety initiatives on a line-by-line basis, and provide specific detail respecting any over- or under-expenditures as part of the Minimum Filing Requirements and that each safety initiative be evaluated for anticipated benefits on an annual basis.**

Refer to Section 4.4 of this Report for a complete commentary on this Recommendation.

**Safe Driver Recognition and Business Recognition Programs**

The Panel commends the Auto Fund for undertaking its current reviews of the SDR and BR programs, and looks forward to initiatives that will help to promote traffic safety. Because these reviews could have an impact on safety, and therefore rates, the Panel recommends:

> **that reviews by SAF of the Safe Driver Recognition and Business Recognition programs be included in the Minimum Filing Requirements of future Applications.**

Refer to Section 4.5 of this Report for a complete commentary on this Recommendation.

**Auto Body Shop Labour Rates**

In its Application, the Auto Fund states that one of the main reasons for the requested increase in the general rate is a negotiated agreement with the province's auto body shops, which included labour rate increases of 10% for each of 2014, 2015 and 2016. One factor leading to the agreement was a study of the health of the collision repair industry, which shows that smaller shops, particularly in rural areas, may not be viable, and that the industry is struggling to attract and retain qualified technicians.

SAF is seeking to achieve efficiencies and improve customer service through an Appraisal Transition Project, which would allow certified shops to perform appraisals, reducing the workload on SAF staff, and reducing costs. The final phase of the Project is set for 2016, when the auto body shops begin doing online estimating under SAF supervision. The Panel recommends:

> **that SAF file a report on the efficiencies and customer service enhancements that are anticipated to occur, and to provide an updated status report regarding the number of closures or additions of body shops in the province, especially in the rural areas, as well as an evaluation of the success in attracting body repair journeyman into the industry, including how many successful candidates are employed in rural areas.**

Refer to Section 4.6 of this Report for a complete commentary on this Recommendation.

**Sensitivity Analysis**

As part of their analysis of the Application, the Consultants asked SAF to assess the impact of several scenarios on the overall rate requirement, RSR levels and MCT ratios. The results demonstrated both the impacts and the likelihood of the various scenarios. Based on the information that was gathered, the Panel recommends:

> **that the Auto Fund include, as part of its Minimum Filing Requirements, a Statement of Operations for four potential scenarios, including separate line items for Rate**

**Stabilization Reserve components for the capital build/release program and capital maintenance provisions, and also showing resulting Minimum Capital Test ratios. The four scenarios are:**

**10% increase or decrease in investment income;**
**0.5% increase or decrease in vehicle volume;**
**0.5% increase or decrease in vehicle drift; and**
**10% increase or decrease in Traffic Safety costs.**

Refer to Section 4.7 of this Report for a complete commentary on this Recommendation.

## Observations

While reviewing the proposed rate increases, the Panel made observations that it felt are worthy of review by the Saskatchewan Auto Fund, its customers, the public and the provincial government.

**Deductibles**

Any changes to deductible levels would require changes to legislation. However, the Panel notes that during it consultations, several members of the public suggested it is time to review the basic deductible level, which is $700 for most vehicles, and has not changed since 1997. Many of these suggestions from the public were based on the idea that bad drivers should pay more when they are found to be at fault in a collision. Rising repair costs are another consideration. Reliable data on collision repair costs indicates an increase from $204 million in 2007 to an expected $300 million in 2014, an increase of more than 47%.

With respect to CLEAR (Canadian Loss Experience Automobile Rating)-rated vehicles, which covers about 80% of the vehicles in Saskatchewan, the original indicated required rate of 2.3% for CLEAR-rated vehicles would decrease to 1.4% with a $100 deductible increase, to 0.5% with a $200 deductible increase, and to -0.4% with a $300 deductible increase.

The impact of increasing the deductible levels on All Vehicles, where the indicated required rate is 3.4%, would be a decrease in the indicated required rate to 2.5% with a $100 deductible increase, to 1.6% with a $200 deductible increase and to 0.8 with a $300 deductible increase.

Motorcycles, taxis and other vehicle classes with the greatest indicated rate changes – significantly above current or proposed capping levels – would be least affected by increasing deductible levels.

The Panel encourages SAF to consider increasing the basic deductible level as an alternative that could mitigate or eliminate the need for general rate increases.

Refer to Section 5.1 of this Report for complete commentary on this Observation.

**Cross-Canada Rate Comparison/Competitiveness**

The Panel is required, in providing an opinion on the fairness and reasonableness of the rate request, to consider the effect of the proposed change in vehicle insurance rates on the competitiveness of the Auto Fund related to other jurisdictions.

The Consultants note that comparing insurance rates across Canadian jurisdictions is a challenge due to differences that exist including coverage, weather, population and traffic density, road infrastructure, crime levels and vehicle mix. They also note that benefit level coverages across the jurisdictions vary significantly. Further, some elements of the basic insurance offered by public insurance companies in other jurisdictions differ, and private companies are not obligated to ensure all drivers regardless of their driving record, as is the Auto Fund.

The Panel joins with its Consultants in urging SAF to provide written information that explains the limitations of the rate comparison in future applications, and that this documentation should be included in the Minimum Filing Requirements for future applications.

Refer to Section 5.2 of this Report for complete commentary on this Observation.

**Administration Fees**

During its review, the Panel noted that some services provided by the Highway Traffic Board are provided to customers at below cost, which results in other customers subsidizing those services. The Panel urges the Auto Fund to review the fees it charges to achieve cost recovery, and report on these findings in the next application.

Refer to Section 5.3 of this Report for complete commentary on this Observation.

## Table of Contents

# 1.0 Role of the Saskatchewan Rate Review Panel

## 1.1 Authority

Through Order-in-Council dated January 1, 2013, the Minister of Crown Investments Corporation (the Minister) appointed a Ministerial Committee known as the Saskatchewan Rate Review Panel (the Panel). The Panel's mandate states that it shall:

> *conduct a review and provide an opinion of the fairness and reasonableness of proposed Crown corporation rate changes, referred to the Panel by the Minister of Crown Investments Corporation; and incorporate as part of its mandate specific terms of reference for particular Crown corporation rate change reviews that may be attached by further Minister's Order.*

Whether in the original Order-in-Council establishing the Panel (437/2000 dated July 27, 2000), or in the Terms of Reference for particular reviews, the Panel has always been instructed to consider: *"…the interests of the customer, the Crown corporation, and the public.*"

The mandate of the Panel extends to three Crown corporations in Saskatchewan – SaskEnergy, SaskPower and SGI's Saskatchewan Auto Fund. Serving as an advisory body to the Minister Responsible for Crown Investments Corporation, the Panel provides independent advice on rate proposals from the above-noted corporations. The final decision about these proposals continues to rest with the Saskatchewan government.

## 1.2 Members of the Panel

Through the January 1, 2013 Minister's Order, the following members were appointed to serve on the Saskatchewan Rate Review Panel:
Chair: Kathy Weber, Saskatoon
Vice-Chair: Bill Barzeele, Little Bear Lake
Members: Steve Kemp, Regina; Delaine Barber, Weyburn; Lyle Walsh, Yorkton;
Daryl Hasein, Biggar; Burl Adams, Kelvington

## 1.3 Panel's Terms of Reference

The Minister issued an Order establishing the Terms of Reference guiding the Panel's review of Saskatchewan Auto Fund's Rate Application. The Minister's Order and the Terms of Reference for this Application identified several factors the Panel is to consider in conducting its review, as well as various parameters the Panel is to consider as "givens."

The Minister's Order for this review called for the Panel to complete its work no later than June 11, 2014. The Minister's Order and the Terms of Reference for this review are located in Appendix A.

## 2.0 Saskatchewan Auto Fund's Rationale for the Application

The Panel received the Auto Fund's Rate Application (the "Application") on February 4, 2014 as "Saskatchewan Auto Fund 2014 Rate Proposal" (attached as Appendix B).

The Auto Fund's rate proposal requests a net 5.2% rate change, to take effect August 31, 2014, including:

- A 2.7% rate increase, with rate rebalancing for all vehicles, with the exception of motorcycles;

- A 2.7% flat rate increase for motorcycles, with no rebalancing; and

- An additional 3.7% increase to all vehicles, including motorcycles, to help replenish the Rate Stabilization Reserve (RSR). This amount would be applied to the rebalanced rate for each vehicle, and flat rate for each motorcycle.

Because there is currently a 1.23% RSR surcharge built into the rates that is effective until August 30, 2014, the average increase customers would pay over their current rates is 5.2%.

The primary reason for the proposed increase in premiums, according to the Application, is a 10% year-over-year increase in labour costs at auto body shops in the province covering the years 2014 to 2016. The SAF also points out that the major cost driver for motorcycle rates is injury claims costs, which account for 73% of all costs in the motorcycle class (unlike CLEAR-rated vehicles where injury makes up approximately 25% of the total required premium), which in large part drives the need for the indicated rate need of 46.8% in the motorcycle class.

The Auto Fund states that the increase in the capital amount is needed to increase the balance in the RSR. The RSR is intended to serve as a cushion to protect customers from large costs due to unexpected events. SAF uses a common industry measure called the Minimum Capital Test (MCT) to ensure there are adequate funds in the RSR.

The Auto Fund states that it recently revised its Capital Management Policy to follow revised guidelines from the Office of the Superintendent of Financial Institutions (OSFI) on setting appropriate financial targets. Rather than setting an MCT range from 75% to 150%, as the SAF's old policy did, their revised Capital Management Policy sets the MCT target ratio at 100%. In addition, the revised policy applies an amount to move towards an MCT of 100% in one-fifth increments in each rate program, instead of waiting for the MCT to fall outside the target range, and then applying larger surcharges or rebates. According to the Application, this smoothes out the impact for customers.

At the end of November 2013, the 12-month rolling average for the MCT was 63%. The proposed 3.7% increase in the capital amount will move the RSR one-fifth of the way toward the current 100% MCT target ratio.

The rate Application also proposes rate rebalancing and capping for all vehicles, except motorcycles. The Auto Fund states that while rebalancing is important to ensure fairness, it proposes to cap rates to reduce rate shock. Using the same capping structure employed in the 2012 and 2013 rate Applications, for annual premiums less than $1000, a dollar cap would be applied. For premiums over $1,000, the maximum would be capped at 15%.

If approved, the Auto Fund states that the increase, with rebalancing, plus the charge to replenish the RSR, would mean rate increases for about 84% of vehicles, with an average annual increase of $49. About 16% of vehicles would see an annual reduction in rates averaging $12. About 3,000 vehicles would experience no rate change.

## 3.0 Review Process for the Auto Fund Application

### 3.1 Technical Consultants

The panel commissioned independent, expert technical consultants to assist with the review of the Rate Application and to provide an independent, technical report (attached as Appendix C).

Brian Pelly of Eckler Ltd. has worked with the panel on five previous Auto Fund reviews and has been an actuarial advisor to the Manitoba Public Utilities Board on reviews of Manitoba Public Insurance since 1998. He is based in Toronto.

Myron Kostelnyk of Kostelnyk Holdings Corp. has served as technical consultant to the panel on Auto Fund Applications since 2005. He has also worked on several SaskEnergy commodity and delivery rate reviews, as well as for SaskPower rate reviews. He is based in Winnipeg.

G. D. (Gerry) Forrest of Forkast Consulting has almost four decades of experience in the policy and energy regulatory sectors, at the national provincial and municipal levels, including as a Deputy Minister in the Manitoba government, and as Chair and CEO of the Manitoba Public Utilities Board for 13 years. He established Forkast Consulting in 2004, where he has applied his expertise to a number of reviews specific studies, and training programs across North America and abroad. Mr. Forrest serves as General Consultant to the Panel. His firm is based in Winnipeg.

Working together, the Consultants conducted a detailed analysis that included an examination of the Application, two rounds of Information Requests, plus supplementary questions and individual discussions with Auto Fund staff to clarify specific points. They reviewed the comments and presentations to the panel, and the transcripts of the public meetings in Regina and Saskatoon. The consultants also participated in several meetings and conference calls with the Panel during the review process, before presenting their final report to the Panel on May 28, 2014. Their independent report is attached as Appendix D.

The panel also engaged the services of a technical writer to assist in preparing this report.

### 3.2 Public Consultations

The panel believes public consultations are an important part of the review process. During this review the consultation process included:

- Public meetings;
- Online messages received through the Panel's website;
- Messages received directly through the Panel's email address;
- Messages received through the Panel's toll-free voice mailbox;
- Messages posted to the Panel's Facebook and Twitter accounts; and
- Postal mail.

All methods for public input were advertised in daily and select weekly newspapers, and information was distributed through Facebook and Twitter. The Auto Fund rate Application received news coverage immediately after the Application was announced. Copies of the

Application were available to the public at SGI's offices and on the Panel's website.

The great majority of comments and questions raised at the meetings and through the other channels provided by the Panel focused on:

- motorcycle rates;
- motorcycle safety training;
- graduated licensing;
- protective clothing for riders;
- problems in sharing the road with other drivers;
- the expectation that measures implemented as a result of the Motorcycle Review Committee will bring positive changes; and
- the severity (or lack thereof) of the penalties imposed on drivers who exhibit poor driving behaviour and put others at risk.

Meetings were held in Regina on April 7 and in Saskatoon on April 9. Riders Against Government Exploitation (R.A.G.E.) made a formal presentation at the Regina meeting, and two individuals also made presentations. Several individuals submitted their comments or raised questions during the question-and-answer sessions at both meetings. Several themes emerged from the public meetings and the comments and questions submitted to the Panel through other channels. These included:

- A need for better driver training, including better training for beginning motorcycle riders;
- Driver inattention and lack of respect for other vehicles on the road, including using the phone or texting while driving;
- A shift in thinking to put more responsibility on the individual driver, rather than the vehicle;
- A need for more enforcement of drivers who break the law;
- Stiffer penalties for poor drivers;
- Criticism of Safe Driver Recognition and Business Recognition programs, including a need for greater incentives for good drivers and programming to encourage poor drivers to upgrade their skills; and
- Anticipation – and guarded optimism - that the changes flowing from the recommendations of the Motorcycle Review Committee and the all party Committee on Traffic Safety will make Saskatchewan roads safer.

The counter proposal presented by R.A.G.E. at the Regina meeting expressed many of these themes. In its presentation, R.A.G.E. proposed that the Auto Fund move away from general rate increases and hold high-risk drivers financially responsible by imposing Financial Demerits on their driver's license for a minimum of three years, and increasing the existing minimum Demerit rate from $25 to $250 per point. The proposal also suggested the policy on license suspensions should be more stringent, and that driving infractions under the Criminal Code should be reviewed and enhanced. It also suggested that personal insurance should be attached to the driver's license, rather than the vehicle.

R.A.G.E. also argued in its counter proposal that its suggested high-risk demerit fees collected on the driver's license over a three-year period would provide the Auto Fund with the revenue it needs, while reducing high-risk driver behavior, enhancing vehicle safety, and reducing the human and vehicle damage costs associated with high-risk driving behaviour. It also urged the Panel to reject the 2014 rate Application and roll rates on motorcycles back to 2012 levels until the effects of the recommendations of the Motorcycle Review Committee become evident.

While many motorcyclists who commented online opposed any further rate increases, several suggested alternatives to simply raising rates. For example, an email from a rider in Saskatoon cited his experiences with other drivers toward motorcycles. The writer suggests most of the close calls he has experienced have been the result of inattention or lack of respect from other drivers. *"The answer is not raising rates, it's cracking down on the people who get motorcyclists into accidents."*[10]

In his presentation at the April 9 meeting in Saskatoon Tim Ponto identified another concern that drew a strong reaction from the audience: drivers who are distracted by texting or using their phone while driving. He said all of the near misses he has experienced on his Harley over the past three years have been due to a driver texting or using their phone. *"There's where the problem is. It's not with us guys out here riding the bikes. It's with the people that are inattentive, and there's no enforcement on it."* [11]

Another motorcyclist suggested in an online submission there should be no more increases on motorcycles until the changes implemented as a result of the Motorcycle Review Committee are known. Another added, *"I hope the changes over the past year will help drop rates."*[12]

Basing rates on an individual's driving record, rather than on the type of vehicle one drives, was a common theme in the comments. Several comments echoed the position taken by R.A.G.E. that drivers, not vehicles, cause accidents. One feedback form noted, *"There are a lot of bad drivers and they should pay more for their insurance. I consider myself a fairly good driver, but I am still paying as much as a young and inexperienced driver for the same vehicle."*[13]

One commenter opposed the 2014 rate proposal in its entirety, but went on to note that since the Safe Driver Recognition program began in 2003, there have been no increases to the $25 charge for each demerit point under the program, and that the three-year surcharge on drivers licenses for high-risk behaviour that had been in effect until 2003 should be reinstated. One email submission stated quite simply, *"I want the BAD DRIVERS TO PAY."*[14]

A few people raised the issue of affordability. One person stated he could not believe the Auto Fund was asking for another increase. *"Give your head a shake and let my wages catch up to*

[10] Email received April 10, 2014
[11] Transcript of Saskatoon public meeting, pages 34-35
[12] Email received April 9, 2014
[13] Feedback form posted April 16, 2014
[14] Email received April 13, 2014

*your ridiculous rate increases."*[15] Another added, *"Even a $49 a year increase for a pensioner is a lot."*[16]

The Panel expresses its appreciation to the people who took the time to comment or to attend a public meeting on the Application. The Panel also thanks Auto Fund representatives for responding to questions or comments during the public meetings, and for preparing a response to the R.A.G.E. submission.

[15] Email received April 12, 2014
[16] Email received April 9, 2014

## 4.0 Panel Recommendations and Analysis

The Auto Fund submitted its Application to the Panel on February 4, 2014. The Panel directed its Consultants to conduct a thorough review of the Application, to consider public input on the Application and to provide the Panel with a technical report. The Panel's review included all aspects of the Auto Fund's revenue requirements, rate design methodology, rate rebalancing and capping policies, Capital Management Policy, investment strategy, OM&A costs, and traffic safety initiatives. After reviewing and assessing this information, and taking into consideration input from the public, the Panel presents the following recommendations to the Minister of the Crown Investments Corporation:

### 4.1. The General Rate Increase

The Panel accepts the Auto Fund's own estimate that it requires an overall 3.4% increase (before imposing the capital margin).[17] However, the Auto Fund's proposal to impose a flat rate increase of 2.7% on motorcycles (without rate rebalancing on motorcycles), thereby spreading its revenue requirement over all vehicle classes, results in a proposed overall rate increase of 2.7%. This also results in a shortfall in the motorcycle class, which SAF says it plans to recover through a combination of claims cost reductions as a result of initiatives flowing from the Motorcycle Review Committee, and funding approximately $6.8 million from the Rate Stabilization Reserve.[18] The Panel cannot agree with this proposal for three reasons:

1 It implies that SAF is budgeting for an operating loss, which is contrary to its basic operating philosophy and inconsistent with the Minister's Terms of Reference that the Auto Fund's mandate is to "operate on a self-sustaining basis over time."

2 Using RSR funds for one class, at the expense of the others, does not meet the test of "fairness and rate stability for all vehicles", and lowers the level of funds in the RSR, requiring larger premiums now and later to make up the difference.

3 It creates a situation where the motorcycle class falls further behind in comparison to the other vehicle classes While the Panel welcomes the proposed safety measures and more stringent licensing initiatives put forward by the Motorcycle Review Committee, it is of the view that it will take some time before the results of these changes will have a significant impact on claims cost trends.

The Panel accepts SAF's 2014 cost allocation methodology and results, as recommended by its Consultants. The Panel accepts its Consultant's opinion that, on balance, SAF's Operations, Maintenance and Administration costs presented are reasonable. The Panel also acknowledges the Consultants' observation that *"The 2014 Application also formalized the use of credibility into the estimation of the overall indicated rate change for each class. This was done*

[17] Saskatchewan Auto Fund 2014 Rate Proposal, P. 4
[18] Responses to first round Information Requests #9 and #10

*judgmentally in the past. Credibility provides an objective and reliable measure of the sufficiency of the past data for deriving the overall rate indication of each class."*[19]

While the Panel notes that claims costs are by far the largest component of the SAF's total costs, representing 80 to 85% of total costs, and are the most difficult to predict, the Panel encourages SAF to seek out further efficiencies in its operations.

The Panel also urges SAF to be more vigilant in its budgeting. For example, the initial estimate for investment income for 2013 was $44.1 million, whereas the final result for the year was $86.7 million, almost double the estimate. Further, given that result, the Panel notes that SAF has budgeted investment income of $46.8 million in 2014. As another example, SAF budgeted about $8 million on building rehabilitation in 2013, while about $6 million was spent.

Regarding Traffic Safety, the Panel recognizes that SAF does not have complete control over budgeting in this area. Costs for items such as Driver Education, implementation of recommendations of the all-party Traffic Safety Committee and a $400,000 contribution to support STARS are examples of costs beyond its control. Further, SAF often works with external partners on safety initiatives where it does not have control over the implementation timetable. However, the Panel urges SAF to watch its budgeting in this area closely. As the Consultants point out, *"… the variances are significant and we would recommend that in the future, SAF prepare a budget that carefully considers actual past experience and strikes a balance between conservatism and underestimation of the requirements to implement the various programs."* [20] There have been instances in recent years where safety initiatives were budgeted for (approximately $70 million in total), but as the Consultants point out, " … *Saskatchewan motorists are being specifically asked to fund, through rates, safety initiatives that have not always been implemented*."[21]

After considering all aspects of the general rate increase, including accepting SAF's estimate that it requires a 3.4% overall rate increase to break even, and concurring with its Consultants that giving special treatment to motorcycle rates failed to meet the test of being just and reasonable, and considering the need to treat all customers fairly, the Panel recommends to the Minister**:**

> **that the overall general rate increase (before the capital amount) be 3.4%, to take effect August 31, 2014**.

## 4.2. Rate Rebalancing and Rate Capping

This Application continues the approach to rate rebalancing and rate capping used in the previous two Applications, with premiums over $1000 set at 15%, and lower premiums at set dollar amounts. The exception in this Application is the motorcycle class, which in the proposal is excluded from rate rebalancing and capping. Even with the current circumstances regarding

[19] Independent Technical Report, P. 17
[20] Independent Technical Report, P. 61
[21] Independent Technical Report, P. 97

motorcycles, particularly the initiatives flowing from the Motorcycle Review Committee, this exception raises questions of fairness in relation to all other vehicle classes.

After a thorough discussion of the issues, the Panel agreed with the recommendation from its Consultants that motorcycles be included in rebalancing and capping. In their analysis, the Consultants note that ensuring stability and fairness in vehicle insurance rating involves minimizing cross-subsidization among vehicle classes. "*As such the proposed treatment specifically for the motorcycle class will not, in its current form, meet that objective.*"[22]

The Panel also shares two other concerns raised by the Consultants regarding the special treatment given to motorcycles in this Application. Firstly, as the Consultants observe, *"… the issue is not so much what should be the recommendation for this year's Application, but more so what principles are going to be the foundation for proposed rate changes for the motorcycle class in this and subsequent Applications. To provide the relief proposed in this Application for the Motorcycle class, an additional burden has still been placed on other ratepayers."*[23]

Secondly, the whole purpose of rate rebalancing is to achieve greater fairness across and within vehicle classes. Excluding motorcycles from rebalancing goes against this objective. As the Consultants observe, *"… to freeze rebalancing for the motorcycle class without determining when the 'thaw' will occur questions the principle of fairness relative to all other vehicle classes.*"[24]

Because of the large rate need in the motorcycle class (an indicated 46.8% rate requirement, in contrast to the proposed 2.7% increase), the Consultants note that with rebalancing, most motorcyclists would experience rate increases at or near the cap. The Panel, in discussing the rate rebalancing and capping proposed in this Application, had concerns about the magnitude of the rate increases some customers, including motorcyclists, might face. With the rebalancing implemented in the 2012 and 2013 rate Applications, almost 95% of all vehicles are paying a rate that is within 5% of the indicated adequate rate. With this in mind, the Panel requested information showing the effects on rates if capping was scaled back by one-third. The information provided by SAF shows these effects. [25] The following table shows the increases/decreases in dollar terms for premiums under $1000. Premiums over $1000 would be capped at a maximum increase/decrease of 10%, rather than 15%.

| Current Annual Rate | Maximum Cap | 2/3 Cap, Rounded |
|---|---|---|
| $1 - $50 | $25 | $17 |
| $51 - $100 | $50 | $33 |
| $101 - $250 | $75 | $50 |
| $251 - $500 | $100 | $67 |
| $501 - $750 | $125 | $83 |
| $751 - $1000 | $150 | $100 |
| over $1000 | 15% | 10% |

[22] Independent Technical Report, P. 40
[23] Ibid., P. 40
[24] Ibid., P. 40
[25] Response to second round Information Request # 14

Capping rates at two-thirds of the proposed capping program would mean a modest increase in the number of vehicles receiving an increase. It would also mean a slight slowdown in the progress toward fairness in rating across all vehicle classes. However, the Panel believes it may be time to take a breather from the somewhat aggressive rebalancing and capping of the previous Applications. As the Consultants note, "*With the progress that has been made in this regard … a lower cap may now be justified to mitigate rate shock more aggressively.*"[26]

Representations from the Taxi industry were notably absent from the public consultation process during this review, in contrast to previous reviews. In the past, representatives of the Taxi industry have made submissions to the Panel regarding their concerns over substantial rate increases, and particularly with the Business Recognition program as it affects their industry. The Panel has repeatedly in its previous reports urged SAF to consult with the industry regarding those concerns.

The Auto Fund began consulting with the Taxi industry in December 2013 regarding its concerns over these long-standing issues. Some of those concerns are being addressed through changes being implemented this year or in 2015. The Panel appreciates SAF's efforts in this regard, and sees these changes as a positive step. The Panel believes the Taxi industry (which shows a 36.3% rate need) will also benefit from a reduced cap. The Panel accepts the Taxi rating structure as presented in the Application.

After taking all of the information into consideration, and recognizing the need to strike a balance of fairness and reasonableness for all Auto Fund customers, the Panel recommends to the Minister:

**that all vehicle classes be included in rate rebalancing, and**

**that rate capping be set at a maximum 10% on premiums over $1000, and at two-thirds of the proposed rate cap in dollar amounts on premiums less than $1000.**

### 4.3. The Capital Amount

The Terms of Reference for this review include the statement that the Panel should consider *"… the reasonableness of the proposed rate changes in the context of the objective to maintain adequate capital within a Rate Stabilization Reserve to serve as a cushion to protect customers from large rate increases within the terms of the SGI Board- approved Capital Management Policy."*

### The Capital Management Policy and the Minimum Capital Test

SAF Board develops and approves a Capital Management Policy that guides the Auto Fund in managing the Rate Stabilization Reserve to ensure it has sufficient funds to cushion SAF from the volatility inherent in investment and underwriting operations, as well as to ensure a positive RSR without the need for excessive rate increases.

[26] Independent Technical Report, P. 95

SAF uses the Minimum Capital Test, a common industry regulatory solvency measurement, to test the adequacy of the capital in the RSR. The MCT is defined by the Office of the Superintendent of Financial Institutions (OSFI). Because OSFI revises its definition of the MCT ratio from time to time, the Panel suggests SAF be proactive in assessing the expected impact of any changes to OSFI's definition of the MCT, and whether SAF's current Capital Management Policy continues to be appropriate.

In November 2013, the SAF Board revised its Capital Management Policy. This new policy established a new MCT target ratio of 100%. The approach used to maintain capital at an appropriate level also changed under this new policy. The capital amount is now made up of two components: a capital build/release provision and a smaller capital maintenance provision to provide for the natural growth in the RSR that is required as the number and premiums of vehicles insured increases. The combined total of these provisions is to be included within rates, and with each rate program, they will be adjusted so as to move the current MCT ratio one-fifth of the way toward the 100% MCT target ratio. The proposed capital amount would remain in rates until SAF filed another rate application to adjust the provisions so as to move them towards the policy target.

For the Panel to assess the reasonableness of the proposed rate change, it needs to assess the reasonableness of the capital amount that results from the application of the Capital Management Policy. As the Consultants note in their report, there are three main aspects of the Capital Management Policy that directly affect the proposed rate change and, therefore, are directly relevant to the Panel's review.[27] These are:

- The MCT ratio of 100%;
- The five-year approach to building capital or releasing capital in the RSR; and
- The capital maintenance provision.

**Minimum Capital Test Target Ratio of 100%**

The Auto Fund selected its MCT target ratio of 100% based on the financial forecasting and stress testing analysis called Dynamic Capital Adequacy Testing (DCAT). DCAT investigations involve developing a multi-year financial forecast of the expected results for an insurance company, and then stressing those results using a variety of possible adverse scenarios to assess the impact on the company's financial strength and solvency status. DCAT investigations are also commonly adapted to support the selection of internal target capital ratios.

SAF's selection of the target ratio of 100% is based on the modeling of an adverse scenario that causes an 88% point decline in MCT ratio over a three-year period. In response to the second round IR #35, SAF provided an alternative approach to modeling this scenario (known to be favoured by OSFI for internal target setting purposes) which indicates that an MCT ratio of about 91.5% would be an appropriate MCT target ratio, all other things being equal. Notwithstanding the results of these two modeling scenarios (between 88% and 91.5%), SAF

[27] Independent Technical Report, P. 32

rounded up the analysis to a 100% target ratio. Considering these two modeling scenarios, the Consultants observed in their report, "… *it appears there is some inherent conservatism in the selection of the MCT target ratio of 100%.*"[28] This conservatism is significant in dollar terms. [29] A 10-percentage point reduction in the MCT target ratio represents a reduction of approximately $28 million to the target dollar level in the RSR.

## The 99th Percentile

The Consultants considered the question of the appropriate adverse scenario percentile level for a Crown corporation monopoly providing basic insurance coverage. SAF stated that adverse scenarios taking place once every 40 years (consistent with a 97.5 percentile) or even once every 20 years (95th percentile) would subject customers to more frequent rate spikes required to replenish the RSR.[30] A lower percentile level should take into account the risk of having the RSR depleted by relatively common adverse circumstances. With this principle in mind, information provided by SAF shows a rough approximation of the reduction in the MCT target ratio due to changing from a 99th to a 97.5 percentile outcome level, would be about 15 percentage points.[31] A reduction of 15 percentage points in the MCT target ratio would represent a reduction of approximately $42 million to the target dollar level of the RSR as of December 31, 2013.

The process of building or releasing RSR funds also raises the issue of intergenerational equity, since funds contributed by today's customers could benefit customers several years from now. Conversely, if funds are released from the RSR, some customers could benefit out of proportion to their previous contributions.

## Choice of Adverse Scenario Modeling Assumptions

The Consultants observe that the selection of the 100% MCT target ratio is based on industry experience in providing personal accident benefits coverage across Canada. SAF made this choice out of concern that its own experience would not be reliable enough for a one-in-100-year adverse scenario. The Consultants found little difference between non-Saskatchewan data and the Auto Fund's own data, and that the Canadian industry assumptions as used by SAF are reasonable for use in Saskatchewan.

## The 5-Year Approach

Regarding the five-year approach to the capital/build release provision, SAF states in that this approach strikes "… *the appropriate balance between making significant movement toward the target, avoiding rate shock for the customer, and keeping the process as straightforward as possible*."[32]

The Consultants note that the expected change in the capital build/release provision in future

[28] Ibid., P. 33
[29] Response to first round Information Request # 42
[30] Response to second round Information Request #46
[31] Independent Technical Report, P. 33
[32] Response to first round Information Request #47

years is modest in comparison with the impact customers would experience in the first year, in other words, with this Application. This raises the question whether the size of the capital build provision could be considered rate shock, on its own, or as part of the overall average rate increase. From the Panel's point of view, the Application of the 3.7% capital amount on top of rebalanced and capped rates will result in some customers subject to the proposed maximum 15% rate cap facing increases of more than 18%, which certainly looks like rate shock.

The Panel urges SAF to amend its Capital Management Policy to limit the change in the total capital amount from one Application to another to 1% (+ or -) to avoid rate shock while replenishing or releasing amounts in the RSR. This is a reasonable approach when taking into account the conservatism in selecting the 100% target and the appropriateness of selecting a 99th percentile outcome level.

The proposed 3.7% capital amount would move the level of the RSR one-fifth of the way toward the target 100% MCT ratio. The Panel notes that the 1.23% RSR surcharge included in the current rate would expire on August 30, 2014, and with its continuation as part of the capital amount, the net effect of the proposed capital amount (3.7%) on current rates would be an increase of approximately 2.5% over and above the general rate increase.

With respect to the proposal to replenish the RSR over a five-year period, the Panel considered the information provided by SAF, which shows that customers would bear the largest impact on their rates in the first year, in part because the remaining difference between the current and target MCT ratios would be spread over another five-year period with each new rate Application.[33] Since the purpose of the RSR is to mitigate rate shock, the Panel suggests that SAF amend its Capital Management Policy to limit the change in the total capital amount from one Application to the next to one percentage point (+ or -), to avoid adding to rate shock while replenishing or releasing amounts from the RSR.

Taking all of this information into consideration, the Panel makes the following recommendations regarding the capital amount to the Minister:

> **that a total capital amount of 2.23% be approved, to take effect August 31, 2014, which is one percentage point greater than the 1.23% Rate Stabilization Reserve surcharge that is in the current rate.**

**And the Panel further recommends:**

> **that SAF bring forward rate adjustments based on the Capital Management Policy annually, regardless of whether this is a full Application, so that the capital amount embedded in rates can be recalibrated to reflect changes in circumstances over the year. These rate adjustments could be contained in a confirmation submission to the Saskatchewan Rate Review Panel, which would verify the change to the Rate Stabilization Reserve.**

[33] Response to first round Information Request # 33

**that SAF include as part of the Minimum Filing Requirements in future Applications discussion regarding any recent, pending or proposed changes to the Minimum Capital Test, and how these have affected or may affect recent or forecasted Minimum Capital Test ratios and the Capital Management Policy.**

## 4.4. Traffic Safety

The Panel notes that SAF introduced a Traffic Safety Initiative Factor for the first time with this Application. This factor accounts for the increased administrative costs and claims cost savings expected to result from implementation of the initiatives proposed by the Special Committee on Traffic Safety. The net effect of all of the Traffic Safety initiative costs and benefits for the August 2014, 2014 to August 30, 2015 rating year was a reduction of 0.2% to the rate indication.[34] From information provided by SAF about the Traffic Safety initiative, the Consultants note that *"Based on study from other jurisdictions, it is expected that there will be a 1% reduction in damage claims costs, a 2% reduction in injury and liability claims costs, and 4.4% in death claims costs."*[35]

The Panel notes that while SAF spent $24.6 million on Traffic Safety programs in 2013, this is expected to rise to $35.2 million in 2014, a significant increase of 43%. Traffic Safety program costs are approximately 3.6% of the total budgeted operating costs and are worthy of scrutiny.

The Panel notes that over the past several years, spending on Traffic Safety programs overall has been below budget estimates. The Panel realizes that SAF does not have control over some of safety initiatives it is required to fund, and that when it works with external partners, it may not control the timing for the implementation of certain initiatives. However, while dollars not spent in a budget year are returned to the RSR, the fact is that vehicle owners are being asked to fund through a portion of their rates, safety programming that has not been implemented. Accordingly, the Panel recommends:

**that the Auto Fund track and report budget and actual Traffic Safety initiatives on a line-by-line basis, and provide specific detail respecting any over- or under-expenditures as part of the Minimum Filing Requirements and that each safety initiative be evaluated for anticipated benefits on an annual basis.**

## 4.5. Safe Driver Recognition and Business Recognition Programs

The Auto Fund is currently reviewing both the Safe Driver Recognition (SDR) and Business Recognition (BR) programs. Both programs are designed to encourage and reward safe driving and penalize drivers who are involved in at-fault accidents.

The Panel supports the Consultants' observation that, *"Under normal circumstances, review and calibration of these programs would be undertaken periodically as part of the SAF's rate review*

[34] Independent Technical Report, P. 17
[35] Independent Technical Report, P. 21

*process in order for this work to be in accordance with accepted actuarial practice in Canada."*[36]

The Panel commends SAF for undertaking these reviews, and looks forward to initiatives that help to promote traffic safety. Because of the impact that these reviews could have on safety, and therefore rates, the Panel recommends**:**

> **that reviews by SAF of the Safe Driver Recognition and Business Recognition programs be included in the Minimum Filing Requirements of future Applications.**

### 4.6. Auto Body Shop Labour Rates

The Auto Fund stated in its Application that a negotiated agreement with the province's auto body repair shops was one of the main reasons for the requested general rate increase. The agreement calls for annual 10% increases in body shop labour rates for three years, beginning in 2014. The last labour rate increase was 2%, in 2011. SAF forecasts that total collision costs will increase from $281 million in 2013 to $300 million in 2014, with the labour cost component rising from $131 million to $145 million.

One factor leading to the labour rate agreement was a joint study prepared for SAF and auto industry groups to examine the health of the collision repair industry in the province, including the pressures on the industry due to the advanced technologies used in vehicles, the sophisticated equipment required in repair shops, and additional training costs for employees. The study found that financially, most shops in Saskatchewan are performing well, relative to other provinces. However, there are a number of smaller shops, mostly in rural areas, that are too small to remain viable. The study also found that the industry is struggling to attract and retain skilled employees, particularly journeyman technicians.

The Consultants expressed a concern that the increase in labour rates alone may not ensure the survival of the smaller shops, while possibly contributing to greater profitability for the larger ones. However, the agreement is in place for the next three years, and SAF is looking for efficiencies through the recently launched Appraisal Transition Project, which would allowed certified shops to perform appraisals, thereby reducing the workload – and associated costs – for SAF staff.

The standard practice for handling damage claims is for an SAF employee, usually a journeyman, to carry out most initial damage assessments at a claims center or a rural repair shop. Many claims require an additional damage assessment, which requires an SAF employee to visit the repair shop and approve the settlement. The Appraisal Transition Project allows SAF to approve supplemental estimates and settlements electronically with shops that acquire the appropriate hardware and software. This saves SAF staff time, reduces the approval time for estimates and settlements, and improves customer satisfaction. SAF has increased its capacity for providing estimates through the Regina and Saskatoon claims centres by approximately 7,200 per year.

[36] Independent Technical Report, P. 18

SAF has stated that for now, it does not expect to see savings in repair costs from 2014 to 2016, but does expect to provide better customer service by handling more appraisals with the same number of staff. SAF does expect more efficiencies will result from the final phase of the project in 2016 when the auto body shops begin doing online estimating.

SAF is of the view that it must balance the need for efficiency and to contain costs, against the need to have effective industry controls in place. SAF is monitoring the progress of this project carefully, and the Panel recommends

> **that SAF file a report on the efficiencies and customer service enhancements that are anticipated to occur, and to provide an updated status report regarding the number of closures or additions of body shops in the province, especially in the rural areas, as well as an evaluation of the success in attracting body repair journeyman into the industry, including how many successful candidates are employed in rural areas.**

## 4.7. Sensitivity Analysis

As part of their analysis, the Consultants asked SAF to assess the impact of eight positive and eight negative scenarios on the overall rate requirement, RSR levels and MCT ratios, for the years 2014 to 2018. This sensitivity analysis examined some of the basic revenue and expense items that SAF uses in preparing its forecasts. The Consultants note that a 10% increase/decrease in claims costs would have the most dramatic effect on the RSR and MCT ratios, although SAF considered this one of the least likely scenarios.

One of the more likely scenarios would be a 10% increase/decrease in investment income. This is borne out by SAF’s investment income results in 2013, which jumped from an initial estimate of $44.1 million to an updated estimate of $77.2 million during this review. The final result for the year was $86.7 million, far surpassing both estimates. The Panel therefore requests that SAF provide a mid-Application update on Investment Income in future Applications.

The following table provides an abbreviated view of the impacts of the positive and negative scenarios for claims costs and investment income. The complete table is on page 80 of the Consultants’ report.

| Scenario (in $000s) | Net Premiums Earned | Total Claims & Expenses | Year End RSR Balance | MCT Ratio |
|---|---|---|---|---|
| 2013 Forecast | $804,111 | $877,333 | $173,733 | 66% |
| 2014 Forecast | $872,986 | $977,828 | $161,747 | 57% |
| Positive Scenarios and Impact | | | | |
| - Claims Incurred Cost – 10% Decrease | 872,986 | 899,913 | 239,662 | 84% |
| - Investment Income – 10% Increase | 872,986 | 977,828 | 168,102 | 60% |
| Negative Scenarios & Impact | | | | |
| - Claims Incurred Cost -- 10% Increase | 872,986 | 1,055,743 | 83,832 | 30% |
| - Investment Income – 10% Decrease | 872,986 | 977,828 | 155,392 | 55% |

At the request of the Consultants, SAF estimated the likelihood of the various scenarios from most to least likely.[37] Based on this information the Panel recommends:

> **that the Auto Fund include, as part of its Minimum Filing Requirements, a Statement of Operations for four potential scenarios, including separate line items for RSR components for the capital build/release program and capital maintenance provisions, and also showing resulting MCT ratios. The four scenarios are:**
>
> **10% increase or decrease in investment income;**
> **0.5% increase or decrease in vehicle volume;**
> **0.5% increase or decrease in vehicle drift; and**
> **10% increase or decrease in Traffic Safety costs.**

[37] Response to second round Information Request # 126

## 5.0 Panel Observations

During the course of its review the Panel discussed several issues it believes should be highlighted as observations worthy of consideration.

### 5.1 Deductibles

Any changes to deductible levels would require changes to legislation. However, the Panel notes that during it consultations, several members of the public suggested it is time to review the basic deductible level, which is $700 for most vehicles, and has not changed since 1997. Many of these suggestions from the public were based on the idea that bad drivers should pay more when they are found to be at fault in a collision. Rising repair costs are another consideration. Reliable data on collision repair costs indicates an increase from $204 million in 2007 to an expected $300 million in 2014, an increase of more than 47%. This is primarily due to more costly materials and electronics used in manufacturing newer vehicles, which makes repairs more complex and more expensive.

At the request of the Panel, SAF provided estimates of the required rate change in 2014 if the basic deductible level was increased by $100, $200 and $300. With respect to CLEAR (Canadian Loss Experience Automobile Rating)-rated vehicles, which covers about 80% of the vehicles in Saskatchewan, the original indicated required rate of 2.3% for CLEAR-rated vehicles would decrease to 1.4% with a $100 deductible increase, 0.5% with a $200 deductible increase, or a decrease to -0.4% with a $300 deductible increase.

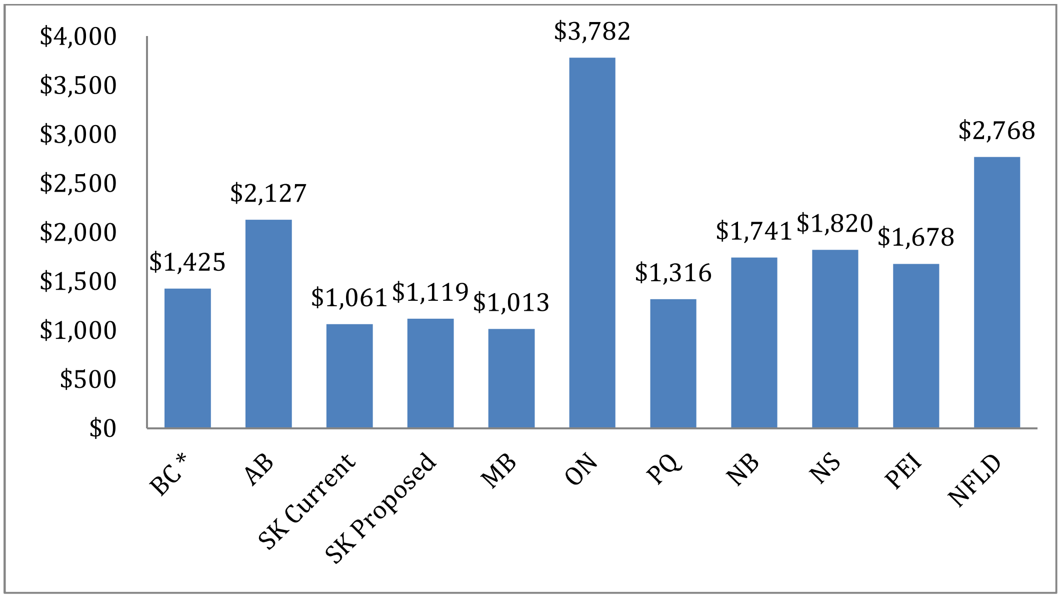
Motorcycles, taxis and other vehicle classes with the greatest indicated rate changes – significantly above current or proposed capping levels – would be least affected by increasing deductible levels. For example, the original indicated rate need of 46.8% for motorcycles would decrease to 46.5% by increasing the deductible by $100. Increasing the deductible by $200 and $300 would result in decreases in the indicated rate to 46.2% and 45.9% respectively.

With respect to All Vehicles, the original indicated required rate of 3.4% would decrease to 2.5% with a $100 deductible increase, to 1.6% with a $200 deductible increase, and to 0.8 with a $300 deductible increase.

The Panel is of the view that increasing the basic deductible would impose a greater cost on drivers at fault in collisions, and would increase their responsibility for the (property liability) costs of collisions. The Panel notes that an increase in the deductible would not necessarily expose motorists to greater risk, since Auto Fund customers could purchase extension insurance in the marketplace to lower their deductibles. Therefore, the Panel encourages SAF to consider increasing the basic deductible level as an alternative that could mitigate or eliminate the need for general rate increases.

### 5.2 Cross-Canada Rate Comparison/ Competitiveness

As part of the Minister's Order for this review the Panel is required, in providing an opinion on the fairness and reasonableness of the rate request, to consider the effect of the proposed change in vehicle insurance rates on the competitiveness of the Auto Fund related to other jurisdictions. In response, SAF prepared a rate comparison that provides insurance rates in 34 different Canadian jurisdictions, for the 22 most popular vehicles insured in Saskatchewan.




*** BC rate based on averages from Jan 1 to Oct 31. Nov & Dec premiums were unavailable. BC rates increased Nov 1.**

The Consultants note that comparing insurance rates across Canadian jurisdictions is a challenge due to differences that exist including coverage, weather, population and traffic density, road infrastructure, crime levels and vehicle mix. They also note that benefit level coverages across the jurisdictions vary significantly. Further, some elements of the basic insurance offered by public insurance companies in other jurisdictions differ, and private companies are not obligated to ensure all drivers regardless of their driving record, as is the Auto Fund. In addition, private insurance companies are not constrained by maximum mandated premiums that they are able to charge.

The Panel joins with its Consultants in urging SAF to provide written information that explains the limitations of the rate comparison in future Applications, and that this documentation should be included in the Minimum Filing Requirements for future Applications.

## 5.3 Administration Fees

In the interest of fairness, the Panel requests that SGI review the fees it charges for services provided by the Highway Traffic Board, and the fee structure for all other products and services it offers to its customers. During their review, the Consultants noted that some services are provided to customers at below cost, which results in other customers subsidizing those services. The Panel urges the Auto Fund to study the various fees it charges with an objective of achieving cost recovery, and to report on these findings in the next Application.

## 6.0 Impacts

### 6.1 Impact on the Customer

The result of the Panel's recommendations on the general rate increase and the charge to replenish the Rate Stabilization Reserve would be a net increase of 4.4% rather than the 5.2% proposed in SAF's rate Application. The Panel believes that applying the general rate increase at the indicated rate of 3.4% across all vehicle classes addresses the need to be fair to all customers, and provides rate stability. The Panel also believes it is fair to include motorcycles in the rebalancing and capping process. Excluding motorcycles from rebalancing without a plan for resuming rebalancing was a concern for the Panel since it would continue the burden placed on other vehicle classes, and result in a larger shortfall in the motorcycle class that would have to be made up later.

The Panel's recommendation to add one percentage point to the existing RSR surcharge, thereby setting the capital amount to replenish the Rate Stabilization Reserve at 2.23%, rather than the 3.7% capital amount proposed in the Application, lowers the rate that customers would pay. Further, the Panel's recommendation to limit any future increases or decreases in this charge to a maximum one percentage point would limit the potential for rate shock in the future.

The Panel is concerned that customers will not see the increase in the capital amount separated out from the increase (or decrease) in premiums they pay. In past reviews the Panel has urged the Auto Fund, in the interest of transparency, to identify the different components it charges its customers on its bills. The Panel still believes this would be a worthwhile change.

Recognizing that the somewhat aggressive rate rebalancing provisions in the two previous Applications have resulted in great progress toward achieving rate fairness – with almost 95% of all vehicles within 5% of their indicated rate in 2013 – the Panel sees this as an appropriate time to lower the maximum cap. Capping at the lower rate would result in a small increase in the number of vehicles experiencing an increase, and a slowdown in progress toward bringing all vehicles within 5% of their indicated rate. However, the Panel is concerned that under the original proposal some customers would face rate increase of more than 18% (a maximum cap of 15% plus the 3.7% capital amount), which could be considered rate shock. Recognizing that the people of Saskatchewan are experiencing price increase in many areas, the Panel believes the recommendation to scale back the cap by one-third or to 10% is a positive move.

The Panel's recommendation to scale back capping by one-third, with the maximum capping rate on premiums over $1000 set at 10%, rather than the proposed 15%, and dollar amounts on premiums under $1000 adjusted accordingly, would provide some rate relief for Auto Fund customers, in particular motorcyclists and the Taxi industry. The Panel notes that while the maximum whole-year premium increase on motorcycles would be $323, many motorcycles will be licensed for six months or less, cutting the dollar amount of the increase at least in half.

The Panel also notes that several recommendations made by an all-party Traffic Safety Committee will be implemented effective June 27, 2014. There is an expectation that these measures will improve traffic safety, and reduce injuries and fatalities on our roads. If so, all

Auto Fund customers will benefit from these changes through lower claims costs.

## 6.2 Impact on the Crown Corporation – SGI

The Panel believes that its recommendation to set the general rate increase at the indicated rate of 3.4% is the best approach, because it will allow the Auto Fund to cover its expected operating expenses and obligations. This approach would eliminate the shortfall of $6.8 million in the rate, and the need to fund the shortfall from the Rate Stabilization Reserve.

The Panel also believes that SAF's customers would welcome the lower rate cap it is recommending, which would be beneficial for the Auto Fund's relationship with its customers.

The reaction from the public to this rate Application was muted compared to the strong opposition that quickly emerged following the announcement of the 2013 rate proposal. However, during this review, attendance at the public meetings and in the comments and questions submitted to the Panel through various methods – predominantly from motorcyclists – indicate that some customers still perceive the Auto Fund as being out of touch with their needs.

## 6.3 Impact on the Public

The Panel welcomes the initiatives SAF is taking to improve traffic safety, with the expectation that these initiatives will help to reduce claims costs and deliver safety-related benefits to the public in general, and in specific areas such as health care.

All citizens of Saskatchewan, whether they are Auto Fund customers or not, are shareholders and have an interest in its operation. Since the mandate of the Auto Fund is to be self-sustaining – with revenues and costs breaking even over time – and does not earn profits or pay dividends, the recommended increase would not have any effect on the public as shareholders.

## 7.0 In Appreciation

The Panel thanks the Saskatchewan Auto Fund for the assistance it provided during this review process, which was helpful throughout. The Panel wishes to acknowledge the work that the SAF has done on the Safe Driver Recognition and Business Recognition programs, and on the Motorcycle Review and Taxi industry consultations. This work requires significant staff time, resources and effort. The Panel encourages the SAF to continue to address the immediate and long-term concerns of the Taxi industry and the motorcycle community.

The Panel thanks Forkast Consulting, Eckler Ltd. and Kostelnyk Holding Corporation for their thorough analysis of the Application.

The Panel thanks Bill Armstrong for his assistance in preparing this report.

Finally, the Panel acknowledges the members of the public who participated in the review process. The Panel thanks everyone who expressed their views about the proposed rate increase through the various communication channels provided. Every contribution, whether it be a phone call, an e-mail, attendance at a public meeting or a formal submission, were received and evaluated as part of the Panel's decision-making process.