Canadian Institute of Actuaries | Institut canadien des actuaires

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Subject: FSRA Review – Territory Rating

The Canadian Institute of Actuaries (CIA) is pleased to offer the following comments on FSRA's review of territory rating in Ontario auto insurance. Although specific questions were asked as part of this consultation, we have determined that not all of them relate to actuarial matters, so we have chosen specific areas in which we will be offering our feedback.

In general, the CIA is supportive of the direction taken by FSRA in this initiative. Our comments below are intended to be constructive suggestions to provide the most effective implementation of the proposed approach.

Our feedback draws upon the CIA public statement released in 2022, *Big data and risk classification – Understanding the actuarial and social issues*. In this statement, we advocate for the use of big data for risk classification "subject to critically important limitations relating to protected classes under human rights legislation, such as race, sexual identity, and religious expression" and for risk classification systems to be actuarially fair.

From an actuarial perspective, a fundamental principle for any insurance system where coverage is provided by private insurers on a competitive basis is that differences in insurance prices should be allowed to reflect expected differences in loss cost. There may be public policy reasons that governments or regulators balance this principle with restrictions around how insurance prices can be calculated. For example, in the Ontario auto insurance market, insurers are currently not permitted to use more than 55 rating territories when determining insurance prices.

The CIA supports such restrictions related to protected classes under human rights legislation such as race, sexual identity, and religious expression. The CIA does not have an opinion as to what additional restrictions of this kind may or may not be appropriate. We would point out that there is a risk that such restrictions may have an adverse impact on the insurance market. For example, some consumers may find it difficult to get coverage because insurers are not able to charge an appropriate premium to them due to such restrictions, and so are reluctant to offer coverage. That being said, despite the current restrictions, there are many signs that the Ontario auto insurance market is quite healthy, as new insurers are entering the market and the residual market is not excessive.

Fairness

One question posed by FSRA is “how would you define fairness?” There are many potential definitions of fairness that may be appropriate for a regulated line of insurance. The CIA does not have a position as to a single definition of fairness, but we support the development of a principles-based operational definition of fairness, using the principle of actuarial fairness as a starting point. We acknowledge that prescribing a single common definition for all market participants, and maintaining that static definition, can be onerous. A principles-based approach would be to establish fairness definitions and provide evidence of their compliance, along with an action plan on when/whether to address or disclose, should there be non-compliance. Some fundamental principles can be developed and outcome-focused standard tests can be independently run by FSRA.

The concept of actuarial fairness is a good starting point for any discussion on fairness.

By this principle, differences in premiums for all sub-groups in a population should be proportionate to expected differences in loss cost. Charged premiums by territory may not be actuarially fair, or may be adjusted, for many reasons, including:

- Insurers may charge rates higher than what is indicated in their models due to a belief that certain areas are “risky” in ways that are not captured in the models.
- Models may overstate the indicated loss cost for high-risk areas due to the tendency of some models to overstate tail risk.
- Adjustments not related to loss costs are often made to premiums. For example, discounts that apply to certain new business risks, or where young drivers are charged less than the indicated premium because they are more price sensitive. These adjustments may benefit some geographic areas more than others.

As an outcome-focused test of actuarial fairness across geographic areas, the publication of industry loss ratio data on a regular basis by postal code (grouped by average income, proportion of immigrant population, average premiums, etc.) would be useful. If loss ratios across such segments are very similar (e.g., if Brampton loss ratios are similar to loss ratios in other parts of the Greater Toronto Area or Ontario), this would reassure the public and regulators that rates are actuarially fair. If loss ratios are high for some segments, regulators/insurers would need to investigate and understand why this is the case.

Furthermore, any territory framework should not only be fair and justified, but also seen to be fair by the public.

Principles-based approach

In general, the CIA is supportive of a principles-based approach to regulation, so we are pleased to see FSRA move in this direction. We support experimentation that has the potential to benefit consumers by providing greater choice, competition and availability.

The report lists a set of draft principles that would guide FSRA’s regulatory approach. The CIA supports the balancing between these six key principles and welcomes the recognition of the negative impact of some current requirements on the principles of simplicity and innovation. A balanced regulatory framework will require extensive review and discussion of risk-based principles vs. rate stability principles, and the associated desired outcomes.

We also welcome the review of requirements that may have been intended to improve fairness or affordability but may not have been well supported by evidence, such as contiguity and common territory definition for all coverages requirements. These principles are not inconsistent with core ratemaking principles, but we do note that some could be construed as value-based goals (such as responsiveness and transparency).

Other comments

The CIA supports the position that premiums should, in principle, reflect expected loss level, and consequently supports the review of the limitation of territories in Toronto and the limitation of using one set of definitions for all coverages.

With regards to the principle of simplicity, we felt that the report tended to focus solely on the burdens placed on insurers. Lengthy filing and review processes also hurt consumers, as this may result in delayed implementation of updated rates.

We would also like to caution against the concept of an overall rate cap. We recognize that it may be seen as a middle ground between a pure risk-based approach and one that emphasizes affordability and stability. However, vehicle-level or policy-level capping still requires a set of arbitrary rules and inevitably creates rate disparity between new and renewal business, which may have implications on fairness. We also would be concerned about situations where a cap is set too low, as it needs to be reasonable and allow insurers some leeway when adjusting rates. Insurers should be allowed to obtain overall rate adequacy under any such structure.

The CIA appreciates the opportunity to provide feedback on these issues, and we would welcome further discussion with you throughout this process.

If you have any questions, please contact Chris Fievoli, FCIA, Actuary, Communications and Public Affairs, at 613-236-8196 ext. 119 or chris.fievoli@cia-ica.ca.

Sincerely,

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