FACILITY Association

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Via email: 5YearReview@fsco.gov.on.ca
Via fax: 416-590-7078

Mr. Willie Handler
Senior Manager
Automobile Insurance Policy Unit
Financial Services Commission of Ontario
5160 Yonge Street, 15th Floor
Box 85
Toronto, Ontario M2N 6L9

Dear Mr. Handler,

Thank you very much for the opportunity to provide comments with respect to the Ontario Auto Insurance Five Year Review.

Please find attached Facility Association's submission. Please contact me directly at any time at 416-644-4915 or dsimpson@facilityassociation.com to discuss the submission or any other matters related to Facility Association.

Yours truly,

David J. Simpson, M.B.A., FCIP
President & CEO

Attach.

Facility Association appreciates the opportunity to provide input into the five year review of automobile insurance in Ontario. We fully support the concept of periodic mandatory reviews. Automobile insurance always involves a complex set of dynamics that require occasional investigation and adjustment.

As suggested in the "Appendix – Guide for Comments and Submissions" which accompanied the letter inviting submissions, the focus of our comments will be on affordability and availability as well as improving efficiency and reducing the regulatory burden.

Affordability

Facility Association exists to guarantee the availability of mandatory automobile insurance in six provinces and three territories, regardless of the specific coverage provisions contained in the mandatory policies of each jurisdiction. While we do not have a position on what features an automobile insurance policy should contain, we note the obvious fact that the cost of the policy will bear strong correlation to the benefits provided. We would also note that in the current context of persistently higher gasoline prices, the affordability of operating an automobile is a significant issue for many Ontarians. We therefore respectfully suggest that any review be done from the perspective of limiting the mandatory statutory policy to only the coverages (and coverage amounts) the vast majority of Ontario motorists absolutely need to have, with additional coverages being available for optional purchase by those who want and/or need them.

Availability

As a "market of last resort" we always want the number of vehicles insured through Facility Association to be as small as possible, so that the maximum number of Ontario motorists have their insurance needs met by companies who voluntarily seek their business. We believe the best way to keep residual market volumes small and of maximizing the widespread availability of automobile insurance in the voluntary market is via a system that allows the dynamics of competitive market forces to work for the benefit of Ontario motorists. We believe this is best achieved through a product with relatively stable costs and flexible underwriting and pricing regimes. In reality, Ontario has an automobile insurance product with highly unstable costs and underwriting and rating regulatory regimes that are among the most restrictive in North America. We note that United States jurisdictions which have experience with "take all comers" regimes (e.g. New Jersey) and prior approval rate regulation (e.g. Massachusetts, Georgia) have moved away from these practices in recent years as they have not achieved the desired results of reducing costs and increasing availability and choice for consumers. In fact, the evidence seems to suggest that prior approval rate regulation and underwriting restrictions exacerbate rather than alleviate affordability and availability problems. Based on the experience of other jurisdictions, we support a "file and use" rating system for all automobile insurers and Facility Association as a key means of maximizing availability in the voluntary automobile insurance market.

However, recognizing that political realities may prevent Ontario motorists from benefiting from increased competitiveness through more open pricing and underwriting regulatory regimes, and thus smaller residual markets, we have undertaken a number of initiatives respecting rules and pricing to keep our volumes small since our volumes peaked in the last hard market in March of 2004 (at over 226,000 private passenger exposures).

To be eligible for an automobile policy through Facility Association, applicants must first be declined by at least one insurer and possess a declination letter that is submitted with the Facility Association application. Working with FSCO, we have implemented a robust process for ensuring declination letters are valid. In brief, our Servicing Carrier Facility Association underwriting units are in possession of all authorized declination rules from all Ontario automobile insurers and check each declination letter submitted to ensure that it refers to an authorized and in-force rule.

Recognizing that an element of ‘gamesmanship’ can arise in the pursuit of declination letters if our prices are significantly below those of our members, we have taken a number of steps to ensure our rates are both current and above those of our members:

1. We developed a ‘download facility’ so that more comprehensive data on Facility Association risks is available to our consulting actuaries ‘on demand’ rather than simply thorough the AIX schedule.

2. We conduct more frequent pricing reviews (usually semiannually for private passenger).

3. We conduct regular market monitoring of private passenger prices by running quarterly panels of risk profiles through Compu-Quote (a commercially available quoting service). In the second quarter of this year we conducted our first ever member company pricing survey to determine if there were any pricing conflicts with the voluntary market not revealed by our Compu-Quote review and we intend to conduct similar surveys on an ongoing basis. We do this because if our rates are below those of member insurers, the ironic situation arises whereby member companies taking the entrepreneurial risk of selling automobile insurance (charging regulator-approved prices) find themselves in price competition with what is in essence a cooperative entity backed by the financial strength of the entire industry, in effect competing with themselves!

4. We have developed our rates including a cost of capital provision. However despite the compelling logic of including such a provision (it is an actual cost so sound actuarial practice dictates its inclusion) FSCO continues to disallow its inclusion.

The disallowance of a cost of capital provision in our rates underlines the reality that we are in the hands of the rate regulator in terms of the prices that we charge. We strongly recommend that it be part of FSCO’s mandate to ensure that Facility

Association prices are above those of voluntary companies, particularly those who focus their marketing efforts on ‘non-standard’ risk profiles, i.e., those risks that would otherwise be insured through Facility Association. If including a cost a cost of capital provision in Facility Association rates is not seen to be a viable way of ensuring our rates are appropriately above those of member companies then we suggest a mechanism be developed so that our rates are set with specific reference to the voluntary market.

There are instances of this approach being taken elsewhere. For example, the Plan of Operations of the property insurance residual market mechanism in Louisiana states:

> “A. As a residual market, the Plans made available by the Louisiana Citizens Property Insurance Corporation are not intended to offer rates competitive with the voluntary market.
>
> B. The Corporation will adopt rates, rating plans, and rules for approval by the Governing Board in accordance with Section 6 of this Plan. All rates, rating plans, and rules will be filed with the Department of Insurance for approval.
>
> D. Rates for policies issued under the Coastal Plan and the FAIR Plan shall be set by the Governing Board of the Corporation, adjusted annually, shall be actuarially justified, and for each parish, the average rates of the Plans for each line of business for personal lines residential policies, excluding rates for wind-only policies, shall exceed by at least ten percent the average rates charged by the insurer that had the highest average rate in that parish among the ten insurers with the greatest total direct written premium in the state for that line of business in the preceding year.”

While we are not necessarily recommending this precise mechanism for ensuring that our prices are above those of our members, we believe the principle is sound and would appreciate the opportunity to pursue further dialogue in this regard.

In addition to the above measures to prevent our volumes from rising inappropriately, we have taken additional steps to monitor our volumes. Beyond the monthly written vehicle report we (and FSCO) receive from Insurance Bureau of Canada, we also track Servicing Carrier application counts monthly. We have also implemented a Cognos Cube tool that allows us to analyze the characteristics of written private passenger business so that we can determine, for example, if increased business volumes reflect a particular class of risk, territory, etc.

All that said, our current private passenger exposure count on a rolling 12 month basis is 17,905 as of May 2008. However, we note that the current automobile insurance marketplace in Ontario is reminiscent of 2001 in the sense that residual market volumes are at near record lows and there are rapidly increasing cost pressures, particularly with respect to Accident Benefits. Barring significant change, we would not be surprised to see our volumes increase, perhaps significantly, in the next 6- 24 months.

More specifically, Ontario industry-wide private passenger loss ratios (all coverages combined) went from 76% in 1998 to 101% in 2001. Traditionally, residual market volumes are a lagging indicator of market distress and, sure enough, Facility Association exposure volumes climbed dramatically from about 17,000 in the first quarter of 2002 to approximately 225,000 in the first quarter of 2004. This provides a stark example of what can happen to automobile insurance consumers if swift decisive action is not taken to address rapidly rising costs in the system.

<u>Improving Efficiencies</u>

Facility Association supports the repeal of Bill 5 (The Automobile Insurance Rate Stabilization Act). Under this Act, the specified time frames for the approval of rate filings have been removed. This has added months to the approval process which in turn causes delays in implementing needed rate adjustments. There is also no longer a “deemed complete” letter so that an insurer no longer knows when to expect approval. In the case of our most recent private passenger rate application, the time from submission to approval was four months and the ultimate rate level approved was 15 percentage points below what our highly qualified consulting actuaries advised us was necessary for adequacy.

As this Act only applies to private passenger vehicles, our experience is that applications for rate changes for other classes of business are approved much more quickly.

Easing the Regulatory Burden

From a broader perspective, we support initiatives to move to a more risk-based regulatory system (perhaps one based on a joint government/industry ‘stewardship’ model) that would allow Ontario motorists to benefit from competitive market activity mentioned under “availability” above. Resources in any business are always limited, and they are even more so in some areas of insurance. For example, the ‘talent pool’ of qualified automobile insurance actuaries in Canada is relatively fixed in the short term. The complexities of Ontario’s automobile regulatory regime seem to mean that company resources that could be used to create value for customers are used instead for regulatory compliance. Even a cursory review of automobile insurance in the United Kingdom, and many jurisdictions in the United States, reveals a wider range of creative competitive offerings than those available in Ontario, despite automobile insurance being mandatory in those countries as well.

As we said in our response to FSCO’s draft statement of priorities, in recent years, the Canadian automobile insurance scene has become increasingly fragmented both in terms of product design and regulatory requirements. As a practical matter, FSCO could play a leadership role in reducing the costs of compliance at Facility Association and automobile insurers through the harmonization across jurisdictions of rate profiles and other documents required to support rate filings. We believe there are other cost benefits to be achieved through a focused harmonization initiative as well.

Summary of Key Recommendations

1. That the current (and any) review be done from the perspective of limiting the mandatory statutory policy to only the coverages (and coverage amounts) the vast majority of Ontario motorists absolutely need to have, with additional coverages being available for optional purchase by those who want and/or need them.

2. Based on the experience of other jurisdictions, we support a "file and use" rating system for all automobile insurers and Facility Association as a key means of maximizing availability in the voluntary automobile insurance market.

3. That it be part of FSCO's mandate to ensure that Facility Association prices are above those of voluntary companies, particularly those who focus their marketing efforts on 'non-standard' risk profiles, i.e., those risks that would otherwise be insured through Facility Association.

4. Repeal Bill 5 (The Automobile Insurance Rate Stabilization Act). Under this Act, the specified time frames for the approval of rate filings have been removed. This has added months to the approval process which in turn causes delays in implementing needed rate adjustments.