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Automobile Insurance Territorial Rating - Update

Bulletin

No. A-01/05

- Auto

Property & Casualty

[To the attention of all insurance companies licensed to transact automobile insurance in Ontario]

This bulletin sets out updated guidelines for insurance companies to use when proposing changes to rating by territory and supercedes Auto Bulletin No. A- 4/00 which was released in March 2000.

Background

In March 2000, in FSCO Auto Bulletin No. A- 4/00, parameters were established by FSCO for insurers to follow when making changes to territories in rate and risk classification filings. There were concerns that there was a trend by insurers to increasingly segment territories by postal code and that territories being proposed may not satisfy the statutory standards set out in the *Insurance Act*, (i.e., be just and reasonable, reasonably predictive of risk and distinguish fairly between risks).

A consulting firm was engaged by FSCO to review the issue of territorial rating and in October 2000, FSCO released a *Request for Comment on Proposed Interim Guidelines*. Responses were received from various stakeholders in response to the *Request for Comment* that reflected a divergence of opinions. In 2002 and 2003, the issue of territorial rating was referred to two joint industry/government committees: the Rating and Underwriting Technical Advisory Committee and the Actuarial Advisory Committee. This bulletin has been prepared based on input from these two committees. Outlined below are guidelines for insurers to use when proposing territorial changes in rate filings.

The purpose of these guidelines is to help insurance companies facilitate the preparation of filings so that the rate filings approval process is quicker. These guidelines are applicable for all filing types.

Revised Guidelines for Territorial Rating

1. Minimum number of vehicles in new territory and credibility

All newly formed territories should be based on a minimum of three years of company data and at least 2,500 annualized average vehicles over the three year period where a unique territory definition is proposed.

Credibility is a key consideration in the determination of insurance rates. Based on analysis by the Actuarial Advisory Committee, an average of 2,500 vehicles over a three year period (i.e., the total exposures for the most recent three years insured would be at least 7,500) would give some credence to the territorial experience required to support rates. The standard promotes actuarially sound rates as experience is accumulated.

2. Maximum number of territories

No more than 55 territories in the Province of Ontario and no more than 10 territories in the City of Toronto.

Auto Bulletin A- 1/01, issued by FSCO in February 2001, outlined the fact that in determining whether the statutory standard of "just and reasonable" is satisfied, the Superintendent considers societal fairness when reviewing risk classification systems, and not just actuarial soundness. One of the concerns from a public policy perspective is that if a territory is based on a small geographical area, even though densely populated, socio-economic factors may be influencing loss costs. In addition, drivers may operate their vehicles all over the city, so narrowly defined territories may not be logical. A limit on the number of territories that may be proposed is reasonable and would minimize rate differences due to socio-economic factors.

3. Contiguous territories

All territories must consist of geographic areas that are contiguous i.e., have a common boundary.

Territories are intended to measure risk characteristics such as road conditions, vehicle density, speed limits, crime rates, terrain and weather conditions. There must be some common underlying characteristics in defining the territory, and therefore it is logical that a territory should be comprised of contiguous geographical areas. In addition, there is the concern that territories that are based on non-contiguous geographical areas could lead to "red-lining."

4. Capping for newly formed territories within existing territories

The rates for newly formed adjoining territories should not vary by more than $\pm 10\%$.

When initially establishing a territory, a $\pm 10\%$ cap is to be used to minimize large differences between the existing and proposed territory. Over time, as more data becomes available, the differentials can be adjusted based on the emerging experience. Limiting differentials

indefinitely could lead to market dislocations. This guideline is applicable for each coverage where territory is a rating element.

5. Common territorial definition for coverages

A common territorial definition should be used by an insurer for all coverages.

While data should be examined separately by major coverages, there should be a common territorial definition that the insurer uses for all coverages.

6. Capping of large claims

In establishing territorial rates, large claims should be capped.

So that large claims do not distort the underlying analysis of loss costs, and to avoid rate instability, large claims should be capped, subject to actuarial considerations.

Statistical Plan Update

The current Statistical Plan requires reporting based on 19 statistical territories defined by municipalities and geographical location. As part of the statistical plan changes (to be effective July 1, 2006) insurers will report data by postal code to the statistical plan. The Insurance Information Division of the Insurance Bureau of Canada, as FSCO's designated statistical agent, will be issuing a bulletin with updates to the statistical plan. It is anticipated that premium and loss data could then be available at the Forward Sortation Area (FSA) level. It also may be possible to aggregate the FSA data and group it based on geographical area to provide meaningful and useful information for insurers for rate-making purposes.

Contact

These territorial guidelines are effective immediately and all companies should adhere to these guidelines. Should you have any inquiries regarding this Bulletin, please contact your rate analyst in the Automobile Insurance Services Branch at FSCO.

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