

# Approach



**Effective Date:** October 20, 2021

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## Ontario private passenger automobile annual review based on industry data as of December 31, 2020

### Purpose and scope

This Approach Guidance specifies the Benchmarks for loss trend rates and reform factors<sup>1</sup> (“Benchmarks”) and other key actuarial assumptions that assist FSRA in reviewing Private Passenger Automobile (“PPA”) insurance rate filing applications based on statutory requirements. It supplements the Financial Services Commission of Ontario (“FSCO”) Major

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<sup>1</sup> **Loss trends:** Measure annual rates of change for past and future claims costs (examples of drivers: advancements in safety technology, changes in medical costs, monetary inflation).

**Reform factors:** Restate historical losses to reflect the current level of claims costs as a result of prior product reforms. Reform factors enable the calculation of loss trends without being impacted by the effect of government reforms.

Filing Guideline and FSCO Technical Notes for Automobile Insurance Rate and Risk Classification Filings, which were transferred from FSCO to FSRA following FSRA’s assumption of regulatory authority effective June 8, 2019.

In addition, this Guidance provides a comprehensive list of Benchmark uses, and FSRA’s expectations regarding the use of Benchmarks by insurers’ actuaries.

## Process update

FSRA continues to evaluate and enhance its processes to achieve regulatory efficiency and effectiveness while protecting the interests of consumers. Beginning with this iteration of Benchmark development, FSRA is introducing the following process improvements:

- The scope of the actuarial assumptions analyzed for the annual review has been broadened, while the scope of actuarial assumptions analyzed for the mid-year review remains unchanged.
- Benchmarks will continue to be published twice a year using industry data available from June 30th (“mid-year”) and December 31st (“annual”).
- Consultation will be held for the annual review only. The mid-year update is based on 2021-H1 data and will be appended to the annual review guidance when the information is available.

The information analyzed for the annual review and mid-year update is outlined in the table below.

| Actuarial Assumptions                                      | Annual Review | Mid-Year Update |
|--|---------------|-----------------|
| Loss Trend Rates and Credibility Standards for Loss Trends | ✓             | ✓               |

|  |   |   |
|--|---|---|
| Auto Reform Impact   | ✓ | ✓ |
| Target versus Actual Underwriting Profit                                     | ✓ |   |
| Pre-Tax Return on Investment Rates   | ✓ |   |
| Operating Expense Ratio<br>(By expense category and by distribution channel) | ✓ |   |
| Provincial Government Health Levy and Premium Tax                            | ✓ |   |

Beyond the determination of loss trend rates and the impact of recent auto reforms, this year’s annual review includes:

- a review of the number of vehicles insured, average premiums, and average loss costs per vehicle at the industry level
- an assessment of the impact of COVID-19 on claim costs and claim cost trends in the future
- a review of the pre-tax return on investment rates and underwriting profits
- a review of the industry-wide average operating expense ratios by expense category and by distribution channel
- an assessment of full credibility standards for loss trends

These procedural improvements and expanded contents serve to enable more meaningful feedback, enhance transparency around FSRA’s rate approval considerations and protect consumers by assisting FSRA in determining whether auto insurance rates are just and reasonable.

## Rationale and background

### FSRA mandate

In supervising and regulating the insurance sector, FSRA is required to administer and enforce sector statutes and their respective regulations in a manner that will carry out FSRA's objectives<sup>2</sup>, in particular:

- regulate and supervise the auto insurance sector
- promote high standards of business conduct in the industry
- monitor and evaluate developments and trends related to auto insurance
- contribute to public confidence in the auto insurance sector
- protect the rights and interests of consumers
- promote transparency and disclosure of information
- foster a strong, sustainable, competitive and innovative auto insurance sector

FSRA's Approach as outlined in this Guidance is in furtherance of FSRA's statutory objects and its duties under the Automobile Insurance Rate Stabilization Act, 2003 (AIRSA).

### Ratemaking legal framework

Section 3 of the AIRSA requires that an application ("rate filing") for approval of rates and risk classification systems be in a form approved by FSRA and be filed together with such information, material and evidence as FSRA specifies. Details of the applicable forms are outlined in the Major Filing Guideline and its associated Technical Notes, which this Guidance is intended to supplement.

Section 3 of the AIRSA also requires all insurers writing non-fleet automobile insurance on the Ontario Automobile Policy ("OAP 1") or Ontario Driver's Policy ("OPF 2") to have their rates

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<sup>2</sup> See *Financial Services Regulatory Authority of Ontario Act, 2016*, s.3

and risk classification system approved or authorized by FSRA.<sup>3</sup> FSRA is required to refuse the approval of rate filings if, amongst other factors, the proposed risk classification system or the proposed rates are not “just and reasonable.” Benchmarks are used to assist FSRA in making this determination.

## Principles

FSRA’s statutory obligations and [Rate Regulation Principles](#) (“RRP”) are foundational to FSRA’s approach to auto insurance rate regulation. FSRA’s decision to provide an updated Approach on Benchmarks was guided by the principles of *Transparency & Disclosure* and *Simplicity* under the RRP.

## Benchmarks

### Derivation process

FSRA retained Oliver Wyman (the “Consultant”) to independently derive the loss trend rates and reform factors, the results of which assist FSRA in reviewing insurers’ rate filing applications based on statutory requirements. The Consultant’s report, which outlines the complete derivation of Benchmarks, can be accessed through the links found in [Appendix 1](#).

The Consultant’s analysis reflects feedback that FSRA received through a public consultation process. Further details on this consultation can be found in [FSRA’s consultation summary on Ontario Private Passenger Automobile Annual Review based on Industry Data as of December 31, 2020](#). A summary of the comments received, and the Consultant’s responses may be found in Appendix J of the Consultant’s report.

The Benchmarks analysis is based on the Ontario insurance industry Private Passenger

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<sup>3</sup> Pursuant to Section 3(2) of the *Automobile Insurance Rate Stabilization Act, 2003*, an application for approval of a risk classification system or rates shall be in a form approved by the Chief Executive Officer and shall be filed together with such information, material and evidence as the Chief Executive Officer may specify. However, for the purposes of this Approach Guidance, the reference will be to FSRA.

Automobile (“PPA”) loss experience reported to the General Insurance Statistical Agency (“GISA”) as of December 31, 2020. FSRA’s actuaries conduct a thorough review of GISA data to ensure its validity and works closely with GISA’s Consulting Actuary to ensure the resulting projections are reasonable (see Appendix 3). As per Actuarial Standards of Practice regarding use of another actuary’s work, the Consultant independently reviewed the reported claim counts and claim amount experience to estimate the ultimate claim counts and claim amounts, and compared their estimated ultimate claim counts and claim amounts to those based on the GISA Consulting Actuary’s loss development factor selections for reasonableness. The Consultant concluded that there are no differences in the GISA Consulting Actuary’s selected factors compared to their selections that would have a material impact on their selected loss trend rates. The Consultant, therefore, accepted and applied the GISA development factors to the underlying loss experience data used in the Benchmark analysis.

## Use of benchmarks

The Benchmarks are a cornerstone of FSRA’s approach to reviewing PPA rate filings.

The majority of premium (or “rate”) an insurer collects pays for losses that its customers will incur in the future. To estimate these future losses, the insurer relies on a variety of assumptions.

FSRA regulates Ontario automobile insurance rates and uses the Benchmarks to evaluate if an insurer’s assumptions are appropriate when the insurer seeks approval for changes to its rates.

Rate-making Benchmarks are used to evaluate:

- *Fair Rates for Consumers:* Given that Benchmarks are calculated using industry experience whereas each insurer uses actuarial assumptions that correspond to their own experience and book of business, the Benchmarks **assist** FSRA in reviewing insurers’ auto insurance rate filing applications based on statutory requirements. For example, benchmarks may help to identify outliers, which enables better allocation of regulatory resources. Ultimately, an insurer’s derivation and rationale provided in their rate filings, not the benchmarks, is what drives a decision to approve filed rates.

- **Market Competition:** Benchmarks provide a means for insurers to compare their loss experience with the industry in building their own actuarial assumptions for projecting future rates. Additionally, Benchmarks are assumptions that can be adopted by new/smaller companies with insufficient data or limited resources.
- **Market Health:** Benchmarks are a tool for FSRA to monitor the insurance industry loss experience and proactively review and respond to emerging issues.

As Benchmarks are developed based on the review of the industry data, which may not represent an individual insurer's business, insurers will no longer be permitted to directly adopt the Benchmarks without justification. FSRA requires that all actuarial assumptions be fully supported with an analysis of the insurers' own data, to the extent credible, regardless of whether FSRA Benchmarks are assumed.

As guided in Section 2620.04 of The Canadian Institute of Actuaries Standards of Practice (CIA SOP)<sup>4</sup>, actuaries are expected to consider one or more sets of related experience when their data is not fully credible.

Additional information on industry-wide average operating expense ratios by expense category and by distribution channel can be found in Section 4.3 of the Consultant's report. Insurers are required to use insurer-specific data to support the assumed expense provision in rate filings.

## Investment return on cash flow assumption

As each insurer has its own unique investment portfolio of assets that reflects their investment strategies, it would be practical for insurers to calculate their own portfolio yield, rather than

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<sup>4</sup> Section 2620.04 of the CIA SOP states that "the actuary would consider the blending of information from subject experience with information from one or more sets of related experience to improve the predictive value of estimates."

applying the industry average investment yield in calculating the present value of cash flows.

FSRA is replacing the current Benchmark investment return on cash flow of 2.25% with a rate selected by each individual insurer that reflects their own unique investment portfolio of assets. The discontinuation of the Benchmark investment return on cash flow adheres to CIA SOP, Section 2620.15-17 which speaks to insurers' use of their own expected investment return when discounting claims in calculating indicated rates. Specifically, Section 2620.15 states that:

*“The investment return rate for calculating the present value of cash flows would reflect the expected investment income to be earned on assets that might be acquired with the net cash flows resulting from the revenue at the indicated rate.”*

Furthermore, the CIA SOP guides that revenues from all sources of funds, rather than investment income revenues generated from risk-free assets only, would be considered in the determination of the indicated rates. Section 2620.01 of the CIA SOP states that:

*“The best estimate present value of cash flows relating to the revenue at the indicated rate should equal the best estimate present value of cash flows relating to the corresponding claim costs and expense costs, plus the present value of a provision for profit, over a specified period of time.”*

FSRA's approach has been, and continues to be, consistent with the CIA SOP in the determination of indicated rates. Accordingly, FSRA expects that the insurers' selected investment return on cash flow assumption will be reasonably close to the insurers' investment yields earned in the recent past as reported in the annual P&C-1 financial statements that insurers filed with prudential regulators. Also, the selected investment return on cash flow assumption should reflect the unique investment portfolio of assets and the anticipated future investment returns of insurers.

## **Selected benchmarks for loss trend rates and reform factors**

The Benchmarks, as outlined below, apply to rate filings submitted on or after **October 20, 2021**.



| Coverage                              | Loss Trend Rate |        |          | Reform |
|---------------------------------------|-----------------|--------|----------|--------|
|                                       | Past            | Future | Cut-off  | Factor |
| Bodily Injury                         | 0.0%            | -6.2%  | 1-Apr-16 | 1.000  |
| Property Damage                       | 4.6%            | 4.6%   | 1-Oct-20 | 1.000  |
| Direct Compensation – Property Damage | 0.5%            | 9.2%   | 1-Jan-13 | 1.000  |
| Accident Benefits - Med/Rehab/AC      | 7.3%            | -1.2%  | 1-Jun-16 | 0.795  |
| Accident Benefits - Disability Income | 6.2%            | -1.7%  | 1-Jun-16 | 0.894  |
| Accident Benefits - Funeral and Death | -1.1%           | -1.1%  | 1-Jun-16 | 1.000  |
| Accident Benefits - Total             | 7.0%            | -1.4%  | 1-Jun-16 | 0.817  |
| Uninsured Automobile                  | -6.2%           | -6.2%  | 1-Oct-20 | 1.000  |
| Collision                             | 9.6%            | 9.6%   | 1-Oct-20 | 1.000  |
| Comprehensive                         | 10.0%           | 10.0%  | 1-Oct-20 | 1.000  |
| Specified Perils                      | 10.0%           | 10.0%  | 1-Oct-20 | 1.000  |

|            |      |      |          |       |
|------------|------|------|----------|-------|
| All Perils | 8.8% | 8.8% | 1-Oct-20 | 1.000 |
| OPCF 44    | 0.7% | 0.7% | 1-Oct-20 | 1.000 |

## Commentary

FSRA has undertaken a thorough review of the Consultant’s analysis on loss trend rates and reform factors and believes that the Consultant’s analysis is prudent and reflective of recent developments and current conditions. Furthermore, the Consultant’s analysis has been developed in accordance with accepted actuarial practices. Therefore, FSRA will be adopting the analysis results as FSRA Benchmarks to assist in reviewing rate filings.

Insurers are also expected to consider the inter-dependency between the loss trend rates and the reform impact in their trend analysis.

[Appendix 2](#) provides a comparison of the new Benchmarks with those previously released. While the future loss trends for the Bodily Injury and Accident Benefits coverages have increased, the future loss trend for all coverages combined has increased modestly due to the partial offset from the Physical Damage coverages. The future loss trends for Property Damage and Direct Compensation – Property Damage coverages have remained relatively stable compared to the previous Benchmarks.

The Benchmarks for loss trend rates and reform factors measure the rate of change in loss cost experience without the influence of COVID-19. Historical loss cost data should be adjusted to remove any impact of COVID-19 prior to the application of the Benchmarks. Further adjustments on the loss cost data may be required to reflect the expected COVID-19 impact on the proposed rating period. Appendix I of the Consultant’s report details the COVID-19 impact on claims cost analysis.

## Effective date and future review

This Approach became effective on **October 20, 2021**. The next Benchmarks development process will begin in Fall 2021.

## About this guidance

This Guidance is an Approach. Approach Guidance describes FSRA's internal principles, processes and practices for supervisory action and application of Chief Executive Officer discretion. Approach Guidance may refer to compliance obligations but does not in and of itself create a compliance obligation. Visit [FSRA's Guidance Framework](#) to learn more.

## Appendices and reference

### Appendix 1 – Associated documents

The table below provides a quick reference to all Guidances, consultation summaries, and benchmarking reports produced since this Approach Guidance was launched.

| Benchmark Effective Period | GISA Data Evaluation Date | Guidance                           | Consultation Summary                           | Supporting Report   |
|----------------------------|---------------------------|------------------------------------|--|---|
| January 31, 2022           | June 30, 2021             | <a href="#">Current Guidance</a>   | N/A  | <b>Oliver Wyman Report:</b> <a href="#">“Ontario Selected Private Passenger Vehicles Loss Trend Rates and Reform Factors”</a> |
| October 20, 2021           | December 31, 2020         | <a href="#">Current Guidance</a>   | <a href="#">“2020-H2 Consultation Summary”</a> | <b>Oliver Wyman Report:</b> <a href="#">“Ontario Selected Private Passenger Vehicles Loss Trend Rates and Reform Factors”</a> |
| June 30, 2021              | June 30, 2020             | <a href="#">“2020-H1 Guidance”</a> | N/A  | <b>Oliver Wyman Report:</b> <a href="#">“Ontario Selected Private Passenger Vehicles Loss Trend Rates and Reform Factors”</a> |
| September 23, 2020         | December 30, 2019         | <a href="#">“2019-H2 Guidance”</a> | <a href="#">“2019-H2 Consultation Summary”</a> | <b>Oliver Wyman Report:</b> <a href="#">“Ontario Selected Private Passenger Vehicles Loss Trend Rates and Reform Factors”</a> |

|                         |                  |   |   |   |
|-------------------------|------------------|---|---|---|
| <b>May 15,<br/>2020</b> | June 30,<br>2019 | <a href="#"><u>"2019-H1<br/>Guidance"</u></a> | <a href="#"><u>"2019-H1<br/>Consultation<br/>Summary"</u></a> | <b>Oliver Wyman Report:</b><br><a href="#"><u>"Ontario Selected Private<br/>Passenger Vehicles Loss<br/>Trend Rates and Reform<br/>Factors"</u></a> |
|-------------------------|------------------|---|---|---|

## Appendix 2 – Comparison to previous benchmarks

This appendix focuses on the change in future loss trend rates by comparing the previous Benchmark as of June 30, 2020 and the new Benchmark as of December 31, 2020. Future loss trend rates reflect the expected annual rates of change for claims costs. On an overall basis (“All Coverages Combined”), the Benchmark future loss trend rate has increased modestly from 2.9% to 3.1%. The table below illustrates this change as well as the changes in the underlying major coverages which drive the total change.

| Coverage                              | Future Loss Trend Rate |               |
|---------------------------------------|------------------------|---------------|
|                                       | Previous Benchmark     | New Benchmark |
| Bodily Injury                         | -8.0%                  | -6.2%         |
| Accident Benefits                     | -2.1%                  | -1.4%         |
| Direct Compensation - Property Damage | 9.2%                   | 9.2%          |
| Collision                             | 9.7%                   | 9.6%          |
| Comprehensive                         | 11.6%                  | 10.0%         |
| <b>All Coverages Combined*</b>        | <b>2.9%</b>            | <b>3.1%</b>   |

*\*Note: All Coverages Combined is a weighted sum of the component coverage based on each coverage’s share of losses*

The increase is mainly driven by increased future loss trends for the Bodily Injury and Accident Benefits coverages. For more detailed information on the change in Benchmarks, please refer to the Commentary section of this Guidance.

## **Appendix 3 – FSRA’s process for reviewing and approving of GISA automobile statistical plan PPA factors report and ultimate loss projections**

This appendix explains how FSRA ensures that the ultimate loss and claim count projections used by the Consultant in its analysis are fit for use.

In addition to reviewing industry aggregate loss development data for each coverage, FSRA reviews every insurer’s loss development data, twice a year, to identify any data reporting issues, changes in claims handling and case reserving practices. FSRA’s actuaries work with GISA’s consulting actuary, assessing the extent of each insurer’s data issues by adding, removing, adjusting each insurer’s data one at a time to understand the impact. GISA’s final Loss Development Factors have accounted for adjustments made to those reporting issues, such that the impact of any distortions is immaterial at the industry aggregate level.

### **References**

[FSRA's Summary of Consultation on Ontario Private Passenger Automobile Annual Review based on Industry Data as of December 31, 2020](#): consistent with its commitment to transparency in rate regulation and guidance development, FSRA conducted a public consultation on the preliminary annual report prior to issuing this Approach Guidance. The summary of consultation page outlines the feedback gathered and how it was considered in the final annual report.

## Appendix 4 – Mid-year update based on industry data as of June 30, 2021

This appendix specifies the loss trend and reform factor benchmarks based on the industry private passenger vehicle data as of June 30, 2021. The Consultant’s report underlying these benchmarks can be found in Appendix 1.

Mid-year benchmarks are now provided as an update and supersede the benchmarks based on data as of December 31, 2020.

### Benchmarks for Loss Trend Rates and Reform Factors

| Coverage                              | Loss Trend Rate |        |          | Reform |
|---------------------------------------|-----------------|--------|----------|--------|
|                                       | Past            | Future | Cut-off  | Factor |
| Bodily Injury                         | 0.7%            | -5.9%  | 1-Apr-16 | 1.000  |
| Property Damage                       | 4.7%            | 4.7%   | 1-Apr-16 | 1.000  |
| Direct Compensation – Property Damage | 0.6%            | 9.0%   | 1-Jan-13 | 1.000  |
| Accident Benefits - Med/Rehab/AC      | 7.4%            | -0.3%  | 1-Jun-16 | 0.788  |
| Accident Benefits - Disability Income | 5.5%            | 0.3%   | 1-Jun-16 | 0.847  |
| Accident Benefits - Funeral and Death | -1.0%           | -1.0%  | 1-Jun-16 | 1.000  |
| Accident Benefits - Total             | 6.9%            | -0.2%  | 1-Jun-16 | 0.802  |



|                      |       |       |          |       |
|----------------------|-------|-------|----------|-------|
| Uninsured Automobile | -8.7% | -4.1% | 1-Jan-15 | 1.000 |
| Collision            | 8.9%  | 8.9%  | 1-Apr-21 | 1.000 |
| Comprehensive        | 9.9%  | 9.9%  | 1-Apr-21 | 1.000 |
| Specified Perils     | 9.9%  | 9.9%  | 1-Apr-21 | 1.000 |
| All Perils           | 8.6%  | 8.6%  | 1-Apr-21 | 1.000 |
| OPCF 44              | 0.7%  | 0.7%  | 1-Apr-21 | 1.000 |

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