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Bureau d'assurance du Canada

Kim Donaldson
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December 20, 2019

Mr. Mark White
Chief Executive Officer
Financial Services Regulatory Authority of Ontario
130 Adelaide Street West, Suite 800
Toronto, Ontario
M5H 3P5

Dear Mr. White:

Insurance Bureau of Canada (IBC) welcomes the opportunity to comment on the Financial Services Regulatory Authority of Ontario (FSRA) public consultation regarding assessments and fees.

As you know, the General/Property and Casualty Insurance Industry Advisory Group (IAG) met this past September and identified a number of recommendations on the proposed fee rule, which it shared with FSRA's board members later that month. Although the various associations represented in the IAG had differing perspectives on some points, overall there was significant consensus on the major issues. IBC would like to reiterate its support for the comments and recommendations submitted by the IAG participants during the earlier consultation.

At present, IBC is very much looking forward to January's key discussions about FSRA's 2019/20 priorities and budget. In FSRA's drafting of these documents, we are hopeful that FSRA will work productively with the government to lay the groundwork for responding to the urgent need for policy measures that will reduce the cost pressures driving the auto insurance premiums people pay to ever-high levels. In pressing this point, we are very mindful of the importance of the cost of auto insurance as a pocket book issue for consumers and for the government.

IBC has been greatly encouraged by FSRA's openness to full consultation with the industry sectors it will regulate and other important stakeholders. Looking to the future, we have every expectation that IBC will be participating actively as a partner with FSRA in securing the stability and well functioning of insurance markets for the benefit of our members' customers and the Ontario public at large.

Sincerely,

Kim Donaldson
Vice-President, Ontario

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Notes to support P&C industry associations' presentation to FSRA Board members on the proposed FSRA Pay Rule

I. Introduction

- We appreciate the opportunity provided to the associations representing the various segments of Ontario's P&C insurance industry to provide our observations and recommendations on the proposed fee rule for FSRA.
- In the very short time that was made available, the associations have consulted among themselves to identify the key advice on the proposed rule that we want to share with the Board members. And we are happy to report that despite different perspectives on some issues brought by each of the associations, overall we have found significant consensus on the messages on which we want to be heard.
- Through this presentation, we hope to answer the questions that we understand FSRA wants to hear from us on. But we will be pleased to try to answer any further questions from you, and are hopeful that you will be able to shed light on some issues that FSRA's background materials have left unclear.

II. Budgetary pressures on FSRA

- Our associations put great value on the importance of creating and maintaining a high-quality regulatory authority for Ontario's financial sectors. As we emphasized throughout the Expert Panel review, we are looking for a regulator that is independent from the government, a regulator whose overall approach emphasizes principle- and evidence-based regulation, and one that is both able and willing to act nimbly when problems arise that threaten the stability of our industries and the interests of consumers.
- We understand that FSRA faces very real budgetary pressures during its initial years of operation. These pressures come with, among other factors, FSRA's establishment as an independent agency; start-up IT and personnel costs; and the regulator's need to acquire new competencies to better oversee important issue areas, such as the medical/rehabilitation services that the P&C industry pays for largely through auto insurance.

III. Industry capability to absorb a sizable increase in ON regulatory costs?

- Clearly, the industry's ability to shoulder a steep rise in regulatory costs is very limited. Insurance companies are already beleaguered by multiple disruptive forces that are continuing to put pressure on insurers from the perspectives of growth, profitability, compliance and risk management.
- Nationally, the P&C industry has been experiencing very low returns by historical standards:
  - Reported ROE in 2016 and 2017 was 5.6% and 6.8%, respectively.
  - For the first half of 2018, OSFI's financial-year results point to an estimated ROE of 2.2%.
- In Ontario almost 50% of P&C revenue comes from auto insurance, a deeply troubled business that has been delivering poor and deteriorating results for several years.
  - While the long-studied need for comprehensive reform of the injury claims components of ON's auto insurance system has been validated, it has not been acted on. Moreover, recent years have seen auto physical damage costs rise at an alarming rate.
  - Yet a further risk to the industry resides in yet-unknown costs that may come from the new government's directions.
- Additionally, and as in the rest of the country, the ON P&C industry has been coping with staggering losses from the steady increase in catastrophic weather events – already in the first half of 2018, these losses in Ontario alone have amounted to an estimated $909 million.

IV. Key factors in the P&C industry's response to the proposed $90M – $115M range in the regulator's budget

- Impact of FSRA's cost projections on the P&C industry
  - According to pp 13 and 14 of FSRA's slide deck, the budget range would add between $1.8M and $12.2M to the industry's regulatory cost burden, and the P&C industry's share of the total FSRA budget would rise from about 35% to 37–38%.
  - In light of the industry's current financial circumstances, companies are in the process of cutting back on expenditures, meaning that higher regulatory costs will have to be accommodated within companies' efforts to reduce overall expenses.

- Accountability/transparency
  - FSRA states that the low-end $90M projection is based on a combination of FSCO and DICO budgets.
    - Question: While it is reasonable to assume that in combining two agencies, some administrative efficiencies are achievable – Has this potential been explored?
  - FSRA states that the high-end $115M projection represents monies "to support transformation and investment."
    - Question: The associations have observed that the information provided by FSRA is not sufficient to enable a full explanation to their members regarding the additional services they would be paying for if the high-end budget is adopted. With particular regard to investment in new technology, the associations have noted that for the last number of years, FSCO has made it a top priority to work on technology modernization and associated process re-design – How much of the product of that work is now available to FSRA to reduce the need for large technology investments while maintaining a high standard of efficient, cost-effective operations?

- Need for adequate notice
  - It is obvious that any major change in the regulator's policies is more difficult for companies to manage if sufficient time is not provided for the industry to make necessary adjustments. With respect to a potentially large increase in regulatory costs, the P&C industry associations agree that this axiom carries some important implications, in particular:
    - The notice of the proposed change should be provided as early as possible – and the rationale transparently explained – to allow informed input from the industry and other stakeholders.
    - When the proposed change would result in significant cost and/or administrative burdens for the industry, every effort should be made to mitigate the impact through such means as graduated implementation of the change and the introduction of offsetting savings/efficiency measures.

RECOMMENDATIONS (1)

From these factors or principles, the associations offer several recommendations for the Board's consideration in its decisions on both the size of the FSRA budget it should approve and the processes to be followed to ensure transparency and accountability of the regulator's budgeting process.

1. Consideration should be given to directing FSRA to set up its budget in layers, starting with a base of core costs and then adding time-limited special-purpose or project funding, separately identified, and whose costs would disappear once the project is completed.

2. In establishing the budget for the first years of FSRA's operation, there should be a clear delineation between start-up costs and those expenses that will be ongoing for the regulator. This will allow the initial costs associated with establishing FSRA and the systems it requires to be eliminated from the budget when this process ends.

3. The principles of transparency and accountability, which the draft fee rule endorses, demand that FSRA's annual budgeting process is vigorous and open. In order to facilitate meaningful input from the industry, the process should include detailed reporting by the regulator of expenditures matched with activity areas and priorities. It should also incorporate the principle that budgetary surpluses and deficits will be explained and accounted for in subsequent years' assessments.

4. FSRA should place a high priority on reforming those regulatory activities that are at present notoriously inefficient and that consume significant resources of the regulator and industry.
    - For example, the current rate regulation system for auto insurance is projected to consume 11% of the regulator's budget. These costs could be substantially reduced through redesign, streamlining and greater reliance on the competitive market to establish auto insurance rates.
    - The processes by which the current regulator grants thousands of licences each year have been identified by the associations as grossly inefficient, duplicative, administratively costly and slow. This is another area where we believe early attention to remediation will significantly reduce ongoing costs to the regulator and the industry.

5. At a general level, FSRA should adopt a "least-cost" approach to carrying out its mandate. Where there are alternative, less costly means to achieving oversight goals, these should be pursued. The process for deciding on new regulatory initiatives should always include transparent analysis of the balance between costs and benefits.

V. <u>Fixed- vs. Variable-Fee Rate</u>

- While the industry associations see the value of having the degree of confidence about future costs that could come with the fixed-rate model, we have agreed that, at least for the first years of FSRA's operations, the variable-rate model is the most sensible one. Our specific recommendations on this issue follow.

RECOMMENDATIONS (2)

6. Adoption of the variable-fee model highlights the importance of ensuring that FSRA's annual budgeting process is robust and respects the need to avoid abrupt increases in costs to the industry funders.

7. As part of the 3-year review of the fee rule, the issue of fixed versus variable rate should be revisited. For this review, FSRA should provide substantive justification for the model it will recommend going forward.

VI. Associations recommendations on other elements of the proposed fee rule

RECOMMENDATIONS (3)

8. The associations support the principle of industry self-funding of its own regulation and note that this principle is reflected in the allocation of funding for the major financial sectors as set out on pages 13 & 14 of FSRA's slide deck.
    - This principle is also consistent with our understanding that it is FSRA's intention to include, within the funding envelope for auto insurance rate regulation, the funding required for the regulator's efforts in implementing auto insurance claims cost control and reform of the auto insurance rate regulation system. Both of these issues are signal priorities for Ontario's auto insurance carriers.

9. At least for the first few years of FSRA's operation, the associations support the proposal to allocate industry assessments for market conduct activities on company shares of Direct Written Premium. This is the best and most accurate measure of industry activity and its interface with consumers within the province – which it is the mandate of FSRA to oversee.

10. Looking forward to the 3-year review, however, some associations advocate for FSRA to bring forward evidence on the regulator's experience with the relative costs of market conduct supervision for the different segments of the P&C industry. Based on that evidence, a case may be made at that time for greater refinement of the cost allocation formula – through assessments and/or activity fees – to match companies' regulatory costs with the proportionate effort applied to their market conduct supervision.

11. Within the P&C insurance sector, it appears that FSRA is proposing a departure from the industry self-funding rule with respect to two subsectors: health care providers and adjuster/agent licensing. We disagree with this proposal.
    - Health care providers (HCPs): FSRA's proposal to hold funding from HCPs to cover the cost of their regulation at current levels would cost insurance carriers an extra $770,000 at the low end of the regulator's budgetary scenario and $2 million at the high end. This is not only inconsistent with the industry self-funding principle, but is also not reflective of the enormous benefits that the medical/rehabilitation community has derived from their participation in Ontario's auto insurance system at compensation rates that are much higher than are paid by workers' compensation or Ontario's public health system. In 2017, 68,000 HCPs billed auto carriers through the system's Health Claims for Auto Insurance (HCAI) system for assessing and treating the approximately 65,000 people reported injured each year. This was a 25% increase in the numbers from 2013. Regarding the principal provider groups serving traffic injured claimants, there was growth in all categories. Only in the case of chiropractors has the HCP workforce growth been modest (at 3%), but that appears to have been more than made up for in the large increases in the numbers of alternative providers – for example, physiotherapists, +50%;

massage therapists, +29%; occupational therapists, +38%; general practitioner physicians, +16%.

Clearly, the numbers do not support any concern that charging HCPs for the full cost of their oversight by FSRA would threaten the availability of their services for accident victims. For this reason we fundamentally reject the notion that HCPs would not be **expected** to share equitably in supporting the regulator's increasing costs.

- Adjuster/agent licensing: On page 36 of FSRA's slide deck, it appears that FSRA may be proposing to reduce the share of regulator funding from these important participants in the P&C insurance system. As noted earlier, there is significant room for improving the efficiency of the regulator's licensing operations. However, we see no reason for exempting adjusters and agents from paying their fair share of regulatory costs.

12. While the associations support the **principle** of requiring all corporate entities to contribute to the cost of their regulation, some are not prepared to endorse a "minimum fee" policy without any information from FSRA on how a minimum amount would be determined and potentially impact their member companies.

VII. Conclusion

Our final message to FSRA's Board members is to emphasize our view that any discussion of a new and potentially higher cost structure for the new regulator must be predicated on the expectation that FSRA will bring positive change to the regulatory environment for P&C insurance and our industry's ongoing ability to meet the needs of our customers. For too long, some of the most serious issues affecting the health of P&C markets – in particular, the high cost of traffic injury claims and a persistently heavy-handed and costly auto rate regulation system – have gone unaddressed by the current insurance regulator. This is the principal reason why our associations endorsed the Expert Panel's vision for a new modern regulator that is able and willing both to remedy long-standing problems in our industry's regulatory environment and to set the stage for meeting the many new challenges that the industry faces today and in the future. Positive, proactive, evidence-based change is what we are now expecting of FSRA.

Summary of Recommendations

1. Consideration should be given to directing FSRA to set up its budget in layers, starting with a base of core costs and then adding time-limited special-purpose or project funding, separately identified and whose costs would disappear once the project had been completed.

2. In establishing the budget for the first years of FSRA's operation, there should be a clear delineation between "start-up" costs and those expenses that will be ongoing for the regulator. This will allow the initial costs associated with establishing FSRA and the systems it requires to be eliminated from the budget when this process ends.

3. The principles of transparency and accountability, which the draft fee rule endorses, demand that FSRA's annual budgeting process is vigorous and open. In order to facilitate meaningful input from the industry, the process should include detailed reporting by the regulator of expenditures matched with activity areas and priorities. It should also incorporate the principle that budgetary surpluses and deficits will be explained and accounted for in subsequent year assessments.

4. FSRA should place a high priority on reforming those regulatory activities that are at present notoriously inefficient and that consume significant resources of the regulator and industry. In particular:
   - The current rate regulation system for auto insurance is projected to consume 11% of the regulator's budget. These costs could be substantially reduced through redesign, streamlining and greater reliance on the competitive market to establish auto insurance rates.
   - The processes by which the current regulator grants thousands of licenses each year have been identified by the associations as grossly inefficient, duplicative, administratively costly and slow. This is another area where we believe early attention to remediation will significantly reduce ongoing costs to the regulator and the industry.

5. At a general level, FSRA should adopt a "least-cost" approach to carrying out its mandate. Where there are alternative, less costly, means to achieving oversight goals, these should be pursued. The process for deciding on new regulatory initiatives should always include transparent analysis of the balance between cost and benefits.

6. Adoption of the variable-fee model highlights the importance of ensuring that FSRA's annual budgeting process is robust and respects the need to avoid abrupt increases in costs to the industry funders.

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