Desjardins

February 25, 2022

Financial Services Regulatory Authority (FSRA)
25 Sheppard Avenue West, Suite 100
Toronto, ON
M2N 6S6

**Re: Consultation on Proposed Guidance for Operational Risk Management Framework in Rating and Underwriting of Automobile Insurance**

On behalf of Desjardins General Insurance Group (DGIG), I am pleased to respond to your request for comment on the Proposed Guidance for Operational Risk Management Framework in Rating and Underwriting of Automobile Insurance.

Desjardins is the leading cooperative financial group in Canada serving over 7 million members and clients across the country. For over 120 years, Desjardins has listened and responded to its members' needs and adapted to change. We provide Canadians with banking, wealth management, life & health insurance, property & casualty insurance, and personal, business, and institutional financial services.

There are approximately 6,000 Ontarians across the province serving their communities and representing the Desjardins brand. In Ontario, the Desjardins Ontario Credit Union (DOCU) is the second largest credit union in the province and the fastest growing credit union in the country. Desjardins General Insurance Group (DGIG) is a subsidiary of Desjardins Group and proud to be the leading personal use auto insurer in Ontario. Desjardins Financial Security (DFS) is the fifth largest Life and Health insurer in the country.

We are members of the Insurance Bureau of Canada (IBC) and Canadian Association of Direct Relationship Insurers (CADRI) and have contributed to and are in support of their detailed recommendations on this topic.

We appreciate FSRA's efforts to make its proposed Operational Risk Management (ORM) guidance principles-based and outcomes-focused. The proposed guidance outlines foundational and sound practices for ORM in the rating and underwriting of automobile insurance, including:

- The ORM cycle (e.g., risk identification and monitoring)
- Foundational practices (e.g., defining risk appetite and defining roles)
- Model governance

**Tremendous value generated by ORM**

Desjardins believes strong ORM practices are in the best interests of our clients and enable regulatory resources to be reallocated from issues of detail surrounding insurer processes to auto insurance system outcomes that are important to consumers and to the health and vibrancy of the regulated sector.

ORM practices should fit the needs of each organization. We believe effective risk management frameworks are holistic, considering the relationship amongst risks. In our view, ORM in the rating and underwriting of automobile insurance is important and should be embedded in the organization's overall ORM framework versus being a standalone item.

**Regulatory Harmonization**

We note that OSFI is conducting consultations on Operational Risk Management (i.e., revised E-21 guideline on Operational Risk Management, industry letter on advanced analytics and model risk and revised model risk guidance). These consultations are expected to be conducted in 2022 and 2023.

Without national regulatory harmonization, most insurers will be faced with increased complexity, cost, and potentially conflicting compliance expectations across the country. Ensuring consistent principle-based and risk-based regulatory ORM approaches across the country would encourage innovation and competition in the insurance space without penalizing insurers for their size, structure complexity, or business model. National regulatory harmonization minimizes regulatory costs borne by consumers.

We urge FSRA and other regulators of the P&C insurance industry to agree upon a single nationally harmonized expectation framework for ORM related guidance. Once it is established, we request that reasonable implementation timeline flexibility be provided to insurers based on the degree of adjustment that must be made to their current practices.

We would like to share additional comments related to key elements of the proposed guidance.

## Operational risk management foundational practices

**Operational Risk Management Cycle**

The proposed guideline states "the insurer can rank any new risk against its pre-existing risks for prioritization purposes and, therefore, can determine how the risk should be managed (e.g., accept, reduce, share, avoid)." Although benchmarking risks against one another is a helpful exercise, new material risks are typically dynamic and generally present great complexity to manage and as such, a simple prioritization will not be adequate to ensure the appropriate risk management strategy has been deployed.

The proposed guideline states, "On a periodic basis, the insurer should also review all high-risk areas (even those that are appropriately mitigated within acceptable levels) in order to have a full understanding of all the significant risks."

We recommended that the intent of this review become clearer. For example, what value is intended to be derived from the review? Is the purpose of the review to re-assess high residual risk areas to determine if they still fall within the risk appetite? As such, when using a risk-based approach, it is very frequent that a residual risk that falls below a certain materiality threshold will not be included in certain risk management activities.

**Defining operational risk appetite for rating and underwriting**

To achieve succinct and clear risk appetite statements, Insurers might have multiple risk appetite statements by category of risk (operational, insurance, data, model, and other risks), that together cover what the guidance refers to as the operational risk appetite for rating and underwriting.

**Second Line of Defense**

The role of risk management is to oversee risk management activities, provide objective and independent review of outcomes, and ensure appropriate actions are taken to mitigate any risks that fall outside of the organization's appetite. The guidance states, around reproducibility: "The second

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line should be able to understand first line's processes and procedures and independently trace the first line's decision-making. This necessarily implies that first line should have current, accurate, and complete documentation that can be reviewed by the second line." We believe that second-line effective challenge and oversight should not rely mainly on procedural documentation by the first line, but rather a much wider array of tools and approaches in reviewing business practices and risk management activities in a truly holistic fashion.

The Insurer should be given ample flexibility by FSRA to determine the appropriate tools and processes embedded within their framework for managing and measuring risk.

**Model Risk Management**

<u>Process to assess model fairness</u>

In the process to assess model fairness, FSRA states that "the goal of modelling should not be only to maximize predictive performance but to do so subject to a fairness constraint". We note that outlined in the Actuarial Standards of Practice No.12:

> "Rates within a risk classification system would be considered equitable if differences in rates reflect material differences in expected cost for risk characteristics. In the context of rates, the word fair is often used in place of the word equitable."

Additionally, in response to a comment brought forth by the ASOP No.12 task force regarding the inclusion of the terms "equitable" and "fair":

> "These terms are intended to apply to a risk classification system only to the extent the risk classification system applies to rates. As such, a formal definition was not added. Court decisions notwithstanding, there is no general agreement as to what characterizes "equitable" classification systems or "fair" discrimination."

Consequently, given that the outcome of fairness can be principally addressed by prohibiting unfair rate factor variables, we recommend that FSRA refrain from using references to "fairness" in model risk management and instead focus on desired outcomes such as limiting customer rate dislocation.

The act of considering customer rate dislocation can be separate from the objectives defined in creating, updating, or maintaining a model. For example, tools such as capping exist to ensure a "fair" implementation of rating algorithms.

Thank you for the opportunity to provide our commentary.

Sincerely,

Sam Palmerio
Manager, Government Relations
Desjardins Group