FSRA

Financial Services Regulatory
Authority of Ontario

REPORT OF THE

CHIEF EXECUTIVE OFFICER

ON THE FACILITY ASSOCIATION

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Financial Services Regulatory Authority (FSRA)
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Note: Prepared under delegated authority

I. INTRODUCTION

Section 11.1 of the *Compulsory Automobile Insurance Act,* R.S.O. 1990, Chapter C.25 (the *Act*), requires FSRA[1] to make an annual report to the Finance Minister on the affairs of the Facility Association (the Association). The Minister is required to table this report before the Legislative Assembly. FSRA is reporting on the financial affairs of the Association for the fiscal year ended October 31, 2020, and other significant issues to date.

FSRA conducted a review of the Association in June 2021 and carried out the tests and inquiries necessary to determine whether the Association is satisfying its responsibilities under the *Act*. The findings of the examination are included in this report.

II. BUSINESS VOLUME

Residual Market

The number of private passenger vehicles (PPVs) insured in Ontario's residual market was at its lowest point in the first half of 2016 and has been continuously increasing since that time. As of June 30, 2021, there were 9,132 PPVs insured in the residual market. This is a 10% increase over the same period last year and represents a significant decline in growth compared to 2020 (+82%) and 2019 (+71%). The PPV residual market share remains low at 0.1% and it is well below the 2003 market share peak of 3.9% or 225,000 vehicles.

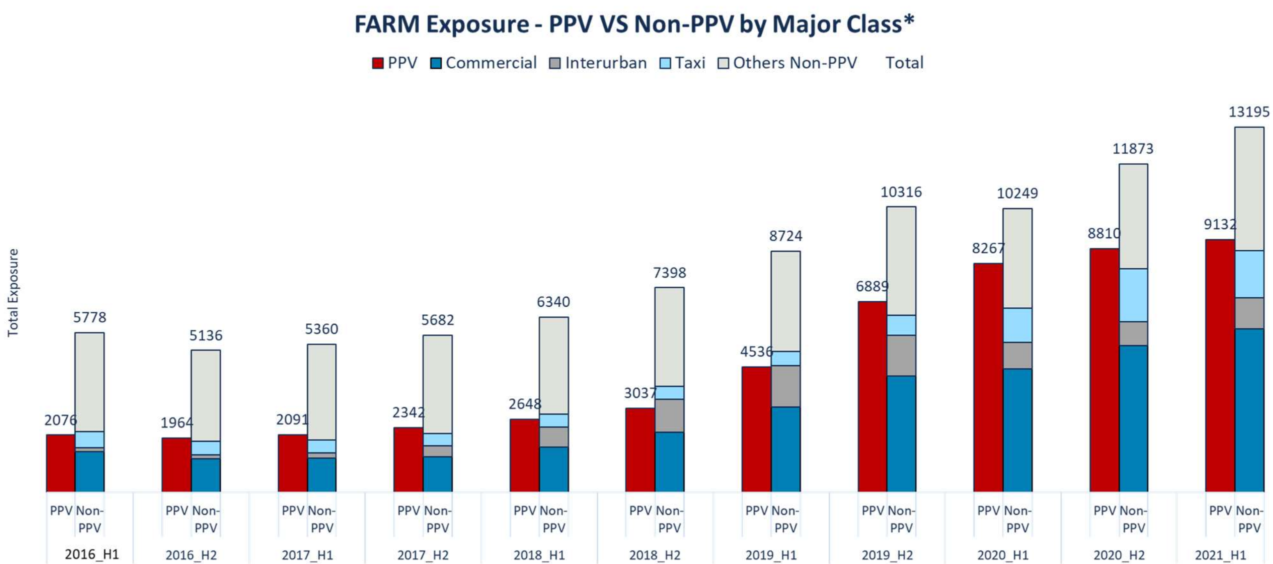
The volume of commercial and interurban vehicles in the residual market has been increasing since 2016 and this trend has continued in 2021. There has been a rise in the number of Ontario operators that either lack commercial driving experience or have no prior insurance. Many of these operators do not qualify for the standard market, which has led to a rise in the residual market. As of June 30, 2021, there were 5,911 commercial vehicles and 1,131 interurban vehicles insured in the residual market which is an increase of 32% and 18%, respectively, over the same period last year. Interurban risks, while up from 2020, are still lower than levels seen in 2019 and 2018. In 2020, the residual market accounted for approximately 1% of commercial vehicles and 6% of interurban vehicles insured in Ontario. This is an increase from the 2019 commercial vehicle market share of approximately 1% but a decrease from the 2019 interurban market share of approximately 10%. [2]

[1] Both the CEO of FSRA and FSRA may exercise regulatory authority under the Act. However, for the purposes of this report, reference will only be made to FSRA as the CEO may delegate his/her regulatory authority to FSRA staff, as permitted by s. 10(2.3) of the *Financial Services Regulatory Authority of Ontario Act.*

[2] The market share is based on 2020 exposure data from the General Insurance Statistical Agency (GISA) and excludes bulk rated fleet policies.

The number of taxis in the residual market has also increased since 2020. As of June 30, 2021, there were 1,701 taxis insured in the residual market. This is a 38% increase over June 30, 2020 which is significant but lower than the 143% increase in the same period last year. Sustained profitability for this line of business remains a concern for the industry and some insurers have stopped writing taxis entirely. In 2020, the residual market accounted for approximately 25% of the taxis insured in Ontario, which is a sharp increase from the 2019 market share of approximately 7%.[3] The total number of taxis insured in Ontario decreased by 30% in 2020 over 2019. The decrease in the overall number of taxis is likely a combined impact of the COVID-19 pandemic, increased insurance and operating costs for taxi owners and operators, and the competition from ridesharing companies.

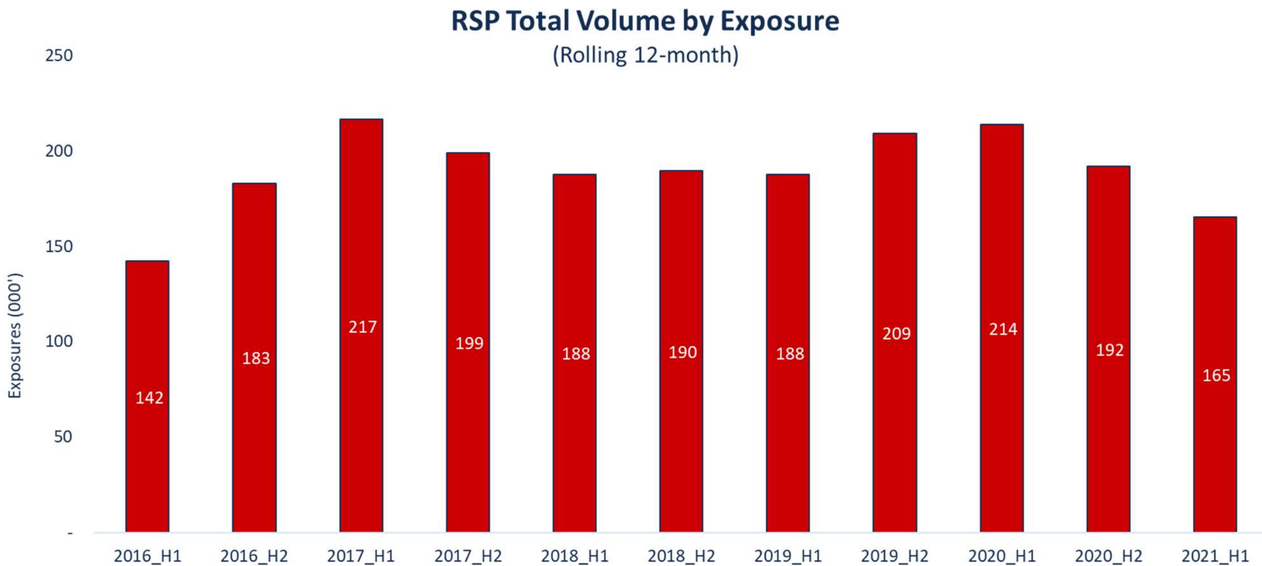
The "Others non-PPV" market has seen significant growth as well. This category includes, but is not limited to, snow vehicles, off-road vehicles, motorhomes, and motorcycles. The volume of Others non-PPV has been stable since 2016 but there has been a recent increase in volumes, perhaps driven by the increase in sales of these vehicle types during the COVID-19 pandemic. As of June 30, 2021, there were 4,453 "Others non-PPV" vehicles insured in the residual market, which is a 24% increase over June 30, 2020. The Association expects that this business will be absorbed by the standard market over time and will monitor the results.



[3] The market share is based on 2020 exposure data from the General Insurance Statistical Agency (GISA) and excludes bulk rated fleet policies.

Risk Sharing Pool (RSP)

Cessions to the RSP have been relatively stable over the last five years and have remained close to 50% of the maximum allowable cession limit of 5%. There was, however, a notable decrease of almost 23% in cessions for the first half 2021 compared to the first half 2020. The decrease in RSP cessions may be associated with higher underwriting profits across the industry and a desire for some insurers to retain more risks as a result.



On October 7, 2020, FSRA approved changes to the Association's Plan of Operation that were related to the harmonization of the RSPs across Canada. Effective January 1, 2022, Ontario members will no longer retain 15% of the risk (premium and claims) and any risk transferred to the RSP will be transferred at 100%. RSP usage is tied to the members' ceding rules, not the retention limit, so this change will not have a significant impact on the RSP cessions.

III. FINANCIAL RESULTS

The Association is defined as an unincorporated non-profit association of insurers under the *Act*. This means that while there may be profits or losses in any given year, the Association is not operating for the financial gain of its members.

FSRA relied on the work of the external auditor of the Association with respect to the quality of the financial statements. The auditor presented an unqualified audit opinion for both the residual market and the Ontario RSP audited financial statements for the year ended October 31, 2020 and reported that it did not identify any material weaknesses in internal controls. The audited financial statements for residual markets (including the Uninsured Automobile Funds) across Canada, as well as the Ontario RSP, were published by the Association.

As with all insurance companies, any changes in the estimates for claims liabilities are recorded in the year the estimates are revised. Estimating claims liabilities is an inherently uncertain process that has been further complicated by multiple changes to the automobile insurance product since 1990. Revisions to estimated claims liabilities for accidents that occurred in prior years can have a significant impact on the calculation of the current year's profits or losses. Therefore, a profit or loss in any particular year is not necessarily a sole result of the events that occurred in that year.

Residual Market

In 2020, the Association recorded a profit of $34 million for residual markets across Canada, as compared to $10 million in 2019. For Ontario alone, the Association recorded a profit of $10 million as compared to $15 million in 2019.

As of October 31, 2020, total assets for residual markets were $775 million compared to $674 million as of October 31, 2019.

These profits and losses do not reflect income and expenses that are directly earned or incurred by the member companies of the Association. Member companies pay premium taxes and health levies directly to the provinces based on direct written premiums. Investment income earned on the Association's funds held by member companies is also not reflected in the Association's financial statements.

RSP

In 2020, the Ontario RSP had a profit of $60 million, as compared to a loss of $126 million in 2019. The last time the Ontario RSP reported a profit was in 2015. The Ontario RSP normally incurs operating deficits as risks placed in the RSP are generally considered to be underpriced. The positive results may be in part due to changes in consumer driving habits because of the COVID-19 pandemic.

As of October 31, 2020, total assets for the Ontario RSP were $1,341 million compared to $1,511 million as of October 31, 2019.

The financial statements for the RSP include only the financial results of the risks transferred to the RSP and the cost of managing it by the Association. The financial statements do not include expenses incurred or revenue earned directly by members in respect of their participation in the RSP.

Enclosed are copies of the audited financial statements for the residual market and the Ontario RSP.

IV. CURRENT ISSUES

Interurban Vehicle Underwriting and Volume

Ontario saw an increase in interurban vehicles in 2018 and 2019, however, this trend was reversed in 2020. With an increase of interurban activity in 2020 in other parts of the country, there is a concern that some Ontario operators may be using jurisdictions outside of Ontario as their home base to gain access to lower insurance rates. This is a concern as loss costs for the residual market are shared among the insurers by jurisdiction. This activity therefore results in lower risk provinces and drivers paying higher premiums to cover the losses of those drivers operating in a higher cost jurisdiction.

The Association has worked with the trucking associations, insurers, and brokers to identify a series of measures and rules to curb this behaviour and slow the growth in this class of business. Interurban vehicle counts are up 18% in the first half of 2021 compared to same period last year, but the volume is still lower than the first half of 2019.

The Association is experiencing increased volumes of interurban vehicles (fleet and individually rated vehicles) with U.S. exposure. This would suggest a lack of availability within the standard market for trucking risks with U.S. exposure. There also appears to be a lack of availability for interurban risks with no prior insurance and interurban drivers with less than three (3) years of heavy commercial vehicle driving experience in Ontario. As a result, much of this business is being written through the Association. It is important to note that in Ontario, underwriting rules and rates for commercial fleet insurance do not require approval by FSRA, so rate regulation is not a factor in an insurer's decision to limit their exposure in this class of business.

Taxi Volumes and Availability

Although the level of growth in the first half of 2021 (+38%) was not as high as 2020 (+143%), taxi insurance availability in Ontario continues to be a concern. Some of the taxis that were idle during the COVID-19 pandemic have returned so an increase in the first half of 2021 was expected. Standard market insurers are still hesitant to write new business and are choosing to restrict the amount of taxi business they accept, while others are choosing to exit the market altogether either due to financial performance or a change in risk appetite. Claims costs and insurance expenses are exceeding premiums received and have been for some time. As a result, the residual market continues to see an increase in the number of taxi exposures.

Despite recent increases in volume, the Association's market share for taxis in Ontario remains low relative to some other provinces.[4] FSRA continues to work closely with the Association to explore opportunities to reduce taxi loss costs and create more availability through the standard market.

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[4] Based on 2019 market share data. The 2020 market share data for other provinces was not available at the time this report was prepared.

Historical Statutory Accident Benefit Claims and Compound Interest
At its annual general meeting in February 2020, the Association raised the issue of historical statutory accident benefit claims and the potential for significant interest payments associated with these claims. Claimants are entitled to interest on overdue benefits from the time they were legally entitled to the benefit, until the date the claim is paid. For statutory accident benefit claims, interest on overdue amounts is set out in the SABS regulation. Prior to 2010, the amount was 2% per month, compounded monthly, (approximately equal to 26% annual rate) which results in substantial amounts if there is a lengthy delay. The interest amount was lowered to 1% per month, compounded monthly, with the introduction of SABS regulation O. Reg. 34/10 in 2010. Interest time and value penalties remain without limits. While this change greatly reduced the exposure of these losses, the potential for significant interest penalties remains a risk on mismanaged claims.

The Association has taken a lead on this issue on behalf of the industry by providing FSRA with potential financial impacts to the industry arising from the Risk Share Pool. The industry has proposed retroactive legislation to amend historical interest, which are changes outside of FSRA's purview. However, FSRA is evaluating potential ways to address the financial risk, including the impact to the loss trend, FSRA's statutory obligation to ensure rates don't impair solvency, capital, and the perverse incentives created by punitive interest that is not compensatory.

V. ENTERPRISE RISK MANAGEMENT (ERM)

The Association continues to develop and refine its ERM program to be more dynamic and to align with the organization's objectives.

The Board engages in a series of risk ranking exercises to identify and prioritize the top risks to the Association before reaching final consensus on risk prioritization. This occurs bi-annually or more frequently, if needed. In turn, the prioritized list of risks forms the basis of risk assessment, monitoring, mitigation, and reporting.

As part of the ERM program, the Association's management team prepares the ERM Status Report and provides it to the audit and risk committee at each of its quarterly meetings. Once approved by the committee, the ERM report is then communicated to the Board of directors quarterly. The ERM Status Report provides the audit and risk committee and the Board of directors with commentary on how the Association is meeting its strategic objectives and information on the status of the individual risks.

The following are the top risks[5] identified by the Association as of March 2021:

1. Government and Regulatory

[5] The Association considers all jurisdictions when prioritizing risks. For the purposes of this report, risks identified in the Association's ERM report which affect more than one jurisdiction only include the risk and mitigation that is applicable to Ontario.

2. COVID-19 Pandemic
3. Third Party Risk – Servicing Carrier
4. Pricing

1. Government and Regulatory

Risk: The risk that the government and regulatory environment becomes more stringent, prescriptive or requirements become overly onerous.

Mitigation:

- The Association meets with FSRA twice per quarter to ensure information from both sides is exchanged in a regular and timely manner. Ad hoc meetings have also been arranged to address pressing issues (e.g. taxis, interurban risks, etc.).
- FSRA's Technical Advisory Committee for Auto Insurance Data and Analytics Strategy, created to improve regulatory efficiency and effectiveness by leveraging data, analytics and technology; includes the Association's Vice President, Data & Analytics.
- The Association has met with MOF and FSRA to discuss the historical statutory accident benefit claims issue and they are assessing the situation and determining what the next steps will be.

2. COVID-19 Pandemic

Risk: The risk that the Association is unable to continue operations due to the COVID-19 pandemic, resulting in the inability to achieve the Association's key objectives. This also includes the risk that the Association does not accurately reflect the impact of the COVID-19 pandemic and its resulting impacts on the economy in pricing and or valuations.

Mitigation:

- Remote working has been implemented for Association employees, to ensure the health and safety for those whose functions can be performed remotely. A work from home policy will likely be in place until at least September 2021. In addition, those who require access to the office are offered transportation. Remote audits will continue throughout 2021.
- A return-to-work strategy is being developed. A working group was formed to assess the logistics of reopening the office. The Association expects that it will transition to a hybrid model with a combination of partial and total permanent work from home arrangements.

3. Third Party Risk – Servicing Carrier

Risk: The risk that Servicing Carriers do not function in accordance with the Plan of Operation, Accounting & Statistical Manual, Claims Guide, and other Association mandated requirements resulting in loss or damage to the Association.

Mitigation:

- Intact is the only remaining Servicing Carrier effective January 1, 2022, but they have expressed a willingness to consider a longer-term commitment.

- The Association is exploring the possibility of extending the withdrawal notice period from 18 months to a minimum of 3 years.
- A working group was formed to assess the risks associated with having a single Servicing Carrier for the Association and to understand the barriers for other members to becoming a Servicing Carrier and the results were submitted to the Board in March 2021.
- Immediate priority was not to secure an additional Servicing Carrier but rather to focus efforts on addressing top barriers for new Servicing Carrier entry. The working group will resume discussions on priority of risks, build a tactical plan to achieve these goals and produce a plan for implementation.

4. <u>Pricing</u>

Risk: The risk that residual market policies are underpriced or incorrectly priced due to incorrect data or techniques applied.

Mitigation:

- Rate changes for 2020 were put on hold due to the COVID-19 pandemic, however the rate assessment cycle for 2021 began in June.
- Potential rate changes for Ontario auto are discussed at the Rates and Rules Advisory Committee meeting before being submitted to the Board.
- Any proposed rate filings will require President or Board approval (scheduled to be presented at the October 21, 2021 Board meeting). If required, rate filings will be submitted by early November 2021.

VI. APPROVED RATE CHANGES

Rate changes for all categories of automobile insurance for the Ontario residual market require prior approval by FSRA. At its May 11, 2020 Special Meeting on the COVID-19 pandemic, the Association's Board agreed to temporarily put a hold on all rate changes. There were no approved rate changes since the last annual report.

VII. PLAN OF OPERATION AND RULE CHANGES

The Association's Plan of Operation, rules, and procedures are subject to prior approval by FSRA. There were three changes approved since the last report:

1. On March 19, 2021, FSRA approved changes to the Ontario Rules and Rates Manual. Revisions were made to the commercial vehicle section of the manual to reduce the minimum optional physical damage deductibles for commercial vehicles and bring them more in line with standard industry practices.

2. On June 10, 2021, FSRA approved changes to the Ontario Rules and Rates Manual. Revisions were made to the commercial vehicle section of the manual to define “common management” within the definition of fleet; clarify the types of losses that impact fleet rating; and define what is not a chargeable accident under the Garage policy.

3. On August 9, 2021, FSRA approved changes to the Ontario Rules and Rates Manual. Revisions were required to implement changes to the Automobile Statistical Plan (ASP) as approved by the General Insurance Statistical Agency (GISA). The changes will aid in tracking information related to Ride Sharing and Ride Hailing services.

VIII. CONCLUSION

FSRA is satisfied that the Association is conducting its affairs in accordance with the *Act,* including making automobile insurance available to those who would otherwise be unable to obtain such insurance in Ontario.

The Association has implemented measures to manage the identified enterprise risks and current issues. FSRA continues to monitor the Association and its activities and provide feedback to enhance its effectiveness.

Enclosures:

1. Audited Financial Statements of Facility Association Residual Market Segment and Uninsured Automobile Funds - October 31, 2020
2. Audited Financial Statements of Facility Association Ontario Risk Sharing Pool - October 31, 2020

APPENDIX A – BACKGROUND

The Association commenced operations in Ontario in 1979 as an insurance industry organization with legal status under the *Act.* All insurance companies that are licensed to underwrite automobile insurance in Ontario are compelled by statute to be members of the Association.

The Association guarantees that automobile insurance will be available to individuals who might otherwise be unable to obtain insurance in the regular market. This is referred to as the residual market. Automobile insurance policies are issued to individuals through insurers that are designated Servicing Carriers. These insurers have contracted with the Association to collect premiums, administer policies, and pay claims on its behalf. The residual market operates in the following provinces and territories: Ontario, Alberta, Nova Scotia, Prince Edward Island, New Brunswick, Newfoundland and Labrador, Yukon, Northwest Territories, and Nunavut.

In addition, the Association has administered the Risk Sharing Pool (RSP) in Ontario since 1993. RSPs commenced operation in Alberta in 2004, in New Brunswick in 2005, in Nova Scotia in 2007, and most recently in Newfoundland and Labrador in 2020. RSPs are a mechanism for transferring risks that member insurers write but do not wish to retain in their book of business. RSP risks are generally considered to be underpriced relative to the risk they present.

The RSP is only for private passenger automobiles. The experience of the RSP is shared across insurers based on their market share of the Ontario private passenger business and the usage of the RSP, each weighted at 50%.

A Board of Directors that is comprised of sixteen members oversees the affairs of the Association. The Board consists of ten insurance company employees, three insurance brokers (approved by the Insurance Brokers Association of Canada), two independent directors, and the President and Chief Executive Officer of the Association. Appendix B provides information of the Board Membership.

APPENDIX B - BOARD OF DIRECTORS

	Name	Company / *Position*	Date Appointed	Notes
1	Christopher Cooney	**TD Insurance** *Vice President, Pricing*	September 2016	Chair
2	Karen Dyberg	**Dyberg Insurance Inc.** *Principal*	February 2016	Deputy Chair IBAC - AB & Territories
3	Dawn Anderson	**RSA Insurance** *Atlantic Portfolio Manager*	February 2019	
4	Patrick Barbeau	**Intact Insurance Company** *Executive Vice President & COO*	February 2014	
5	Michel Dionne	**Aviva Canada Inc.** *Chief Risk Officer*	February 2019	
6	George Hardy	**Co-operators General Insurance Co.** *VP, National Underwriting, Personal Lines*	March 2012	Immediate Past Chair
7	Bob Hillman	**AMA Insurance** *Vice President, Finance*	February 2014	
8	Amanda Ketelaars	**Mitchell & Whale Insurance Brokers Ltd.** *Vice President, Operations*	March 2021	IBAC Ontario
9	Jay Kimball	**GTI Broker Group** *Vice President*	February 2019	IBAC Atlantic
10	Rhonda Lawson	**LMC Consulting** *Partner & Managing Director*	February 2018	Independent
11	Penny-Lynn McPherson	*Lawyer*	February 2019	Independent
12	Louise Morsi	**Economical Insurance** *Vice President, Enterprise Data, Finance*	March 2021	
13	Aaron Perdue	**Millennium Insurance Corporation** *Chief Executive Officer*	February 2016	
14	Jean Roy	**Zurich Canada** *Head of Underwriting Canada*	August 2019	
15	Sharon Turnbull	**Farm Mutual Reinsurance** *AVP, Integrated Analytic Services*	April 2020	
16	Saskia Matheson	**Facility Association** *President & Chief Executive Officer*	February 2019	By virtue of the office