

Auto Insurance Regulatory Oversight

Follow-up to VFM Section 3.01, *2011 Annual Report*

Background

The Financial Services Commission of Ontario (FSCO), an arm's-length regulatory agency of the Ministry of Finance, is responsible for, among other things, regulating the province's insurance sector. FSCO's auto insurance activities include ruling on applications by private-sector insurance companies for changes in the premium rates that vehicle owners pay. FSCO must ensure that proposed premiums are justified based on such factors as an insurance company's past and anticipated claim costs, expenses and what would be a reasonable expected profit. FSCO also periodically reviews the statutory accident benefits available to people injured in auto accidents, and it provides dispute resolution services to settle disagreements between insurers and injured people about entitlement to statutory accident benefits.

In our *2011 Annual Report*, we noted that the government must balance the need for a financially stable auto insurance sector with ensuring that consumers pay affordable and reasonable premiums and receive fair and timely benefits and compensation after an accident. Claims payments are the largest driver of the cost of auto insurance premiums and, in 2010/11, with the average cost

of injury claims in Ontario being about \$56,000 and five times more than the average injury claim in other provinces, Ontario drivers generally paid much higher premiums than other Canadian drivers did. However, claims costs in Ontario were also high because Ontario's coverage provided for one of the most comprehensive and highest benefit levels in Canada.

We noted in 2011 that the government had begun taking action to address the high cost of claims in Ontario. However, we made the following observations that outlined some of the challenges FSCO faced if it was to be more successful in proactively fulfilling its role of protecting the public interest:

- From 2005 to 2010, the total cost of injury claims under the Statutory Accident Benefits Schedule (SABS) rose 150% even though the number of injury claims in the same period increased by only 30%. Benefit payments rose the most in the Greater Toronto Area, where drivers also generally paid much higher premiums.
- FSCO had not routinely obtained assurances from insurance companies that they have paid the proper amounts for claims or that they have handled claims judiciously. Without such assurances, there was a risk that consumers

would not be treated fairly or that unnecessarily high payouts could help insurers obtain FSCO approval for higher premium increases.

- Industry estimates pegged the value of auto insurance fraud in Ontario at between 10% and 15% of the value of 2010 premiums, or as much as \$1.3 billion. Ontario did not have significant measures in place to combat fraud, and the government and FSCO were awaiting the recommendations of a government-appointed anti-fraud task force expected in fall 2012.
- In approving premium rates for individual insurance companies, FSCO allowed insurers a reasonable rate of return on equity—set at 12% in 1996, based on a 1988 benchmark long-term bond rate of 10%. However, that benchmark had not been adjusted downward, even though the long-term bond rate had been about 3% at the time. Furthermore, FSCO needed to improve its documentation to demonstrate that it treats all insurers' premium-rate-change requests consistently and that its approvals are just and reasonable.
- FSCO's mediation service was backlogged to the point that resolution of disputes between claimants and insurers was taking 10 to 12 months, rather than the legislated 60 days.
- The Motor Vehicle Accident Claims Fund, administered by FSCO to compensate people injured in auto accidents when there is no insurer to cover the claim, had \$109 million less in assets as of March 31, 2011, than it needed to satisfy the estimated lifetime costs of all claims currently in the system. This unfunded liability was expected to triple by the 2021/22 fiscal year unless, for instance, the \$15 fee currently added to every driver's licence renewal is doubled.

We made a number of recommendations for improvement and received commitments from FSCO that it would take action to address our concerns.

Status of Actions Taken on Recommendations

FSCO has made progress in addressing most of our recommendations, with significant progress made on several. FSCO was in various stages of implementing changes to help address our recommendations covering the high cost of auto insurance claims and premiums, auto insurance fraud, the process for reviewing insurers' rates filings and their approvals, a backlog in its dispute resolution services, and oversight of how well insurers complied with requirements regarding the processing of claims and ensuring approved rates are used. Although average injury claim costs had declined significantly since 2010, at the time of our follow-up average automobile insurance premiums had not. In addition, discussions held to date had not resulted in any increase to the amount recovered from auto insurers for health-system costs incurred to care for people injured in motor-vehicle accidents.

The status of the actions taken is summarized following each recommendation.

STATUTORY ACCIDENT BENEFITS CLAIMS COSTS

Recommendation 1

In order to ensure that the Financial Services Commission of Ontario (FSCO) can effectively monitor Ontario's auto insurance industry, particularly claims costs and premiums, and recommend timely corrective action to the Minister of Finance when warranted, FSCO should:

- *implement regular interim reviews of the Statutory Accident Benefits Schedule to monitor trends such as unexpected escalating claims costs and premiums between the legislated five-year reviews, in order to take appropriate action earlier, if warranted;*
- *monitor ongoing compliance with the interim Minor Injury Guideline, expedite the work to*

develop evidence-based treatment protocols for minor injuries, and identify and address any lack of clarity in its definitions of injuries;

- *implement its plans as soon as possible to obtain assurance that insurance companies are judiciously administering accident claims in a fair and timely manner; and*
- *examine cost-containment strategies and benefit levels in other provinces to determine which could be applied in Ontario to control this province's relatively high claims costs and premiums.*

Status

Under the *Insurance Act* (Act), the Superintendent of Financial Services (Superintendent) is required to conduct a comprehensive review of the effectiveness and administration of auto insurance at least every five years and make recommendations for improvement to the Minister of Finance. In 2008, FSCO undertook the first statutory five-year review, which led to a report to the Minister of Finance and to legislative changes in September 2010 to the Statutory Accident Benefits Schedule (SABS), a regulation under the Act. In addition to the five-year review, FSCO is required to conduct a legislated review every three years of the risk-classification and rate-determination regulations. As well, FSCO participates in a review of the adequacy of the SABS every two years.

On August 16, 2013, the government proclaimed legislative changes to consolidate multiple auto insurance reviews, including the former five-year review of auto insurance, the three-year review of risk-classification regulations and the two-year review of the SABS. The new consolidated review of the auto insurance system will be initiated at least once every three years, beginning in 2013.

As part of the two-year SABS review, FSCO provided in December 2012 to the Minister of Finance a report that analyzed the impact of the 2010 reforms and the adequacy of accident benefits, including showing that 2011 accident benefits claims costs had decreased following the reforms.

As part of the 2010 auto insurance reforms, FSCO introduced an interim Minor Injury Guideline to provide a broader definition of minor injuries, as well as a \$3,500 minor-injuries benefit limit on the cost of all treatment services and assessments combined. As of November 2012, FSCO changed the form used by health-care providers so that it now requires additional information about whether the treatment is covered by the Guideline.

In July 2012, FSCO retained the consulting services of medical and scientific experts who have been working to develop an evidence-based treatment protocol for the most common injuries from motor-vehicle accidents. The treatment protocol, if approved by government, could be incorporated into a Superintendent's Guideline and used by insurers and health-care providers when treating minor injuries resulting from automobile accidents. The protocol will help to reduce disputes in the auto insurance system and ensure motor-vehicle-accident victims receive effective, scientifically proven treatment. This is a two-year project. The consultants provide regular updates to the Superintendent and, as directed in the 2013 Budget, FSCO will provide an interim report this year on the progress of the project. We were informed that the interim Minor Injury Guideline will be assessed upon completion of the consultants' report and will be addressed as part of a future comprehensive statutory review.

In summer 2011, FSCO introduced a new annual requirement that each insurance company provide it with a statement from its chief executive officer attesting that it had controls, procedures and processes in place to ensure compliance with legislative requirements for the payment and handling of claims. In 2012, on a risk basis, FSCO conducted on-site examinations of 14 auto insurance companies representing 46% of the market share and issued a summary report to the industry outlining the results of this process and identifying areas for improvement. FSCO expected to have visited 16 more companies by August 2013. In 2012, FSCO also introduced a requirement for Ontario

automobile insurers to periodically complete a SABS control questionnaire covering claims handling, including new questions about treatments covered by the interim Minor Injury Guideline. FSCO expected that all insurers would be examined within a four-year cycle to verify the responses and examine insurers' practices.

In addition, new regulations came into force on January 1, 2013, that provided FSCO with the power to impose administrative fines on insurers for not complying with legislative and approval requirements.

As part of its ongoing policy-development work, FSCO gathered information through the Canadian Council of Insurance Regulators on benefit levels and coverage available in other provinces in an effort to identify cost containment strategies that could be applied to Ontario. A draft summary and analysis was prepared in March 2013, and we were advised that an updated version would be used for the 2013 review.

As a result of changes to the SABS in September 2010, the auto insurance industry reports that Ontario's average injury claim cost has decreased more than 50%, from about \$56,000 in 2010 to \$27,000 in 2012. The difference between Ontario's average injury claim costs and those paid by other provinces has narrowed, although Ontario's costs now stand at approximately three times higher than those of other provinces. However, lower accident benefit claim costs have not yet resulted in corresponding lower average premiums paid in Ontario, where the average premium was \$1,551 in 2012, or 8% higher than in 2010, and still the highest in the country.

In August 2013, the government introduced a number of initiatives as part of a strategy to reduce average auto insurance rates by a target of 15%. Since the passing of legislation in August 2013 that gave FSCO the authority to order insurance companies to file rates, FSCO has required certain insurers to submit detailed actuarial filings so it can review claims costs and rates to ensure they are reasonable.

FRAUD IN AUTO INSURANCE

Recommendation 2

To reduce the number of fraudulent claims in Ontario's auto insurance industry and thereby protect the public from unduly high insurance premiums, the Financial Services Commission of Ontario (FSCO) should use its regulatory and oversight powers to:

- *help identify potential measures to combat fraud, including those recommended by the Insurance Bureau of Canada and those in effect in other jurisdictions, assess their applicability and relevance to Ontario, and, when appropriate, provide advice and assistance to the government for their timely implementation; and*
- *ensure development as soon as possible of an overall anti-fraud strategy that spells out the roles and responsibilities of all stakeholders—the government, FSCO, and insurance companies—in combatting auto insurance fraud.*

Status

In 2011, the government appointed the Ontario Auto Insurance Anti-Fraud Task Force (AFTF) to determine the scope and nature of automobile insurance fraud and make recommendations about ways to reduce it. As part of the AFTF, the Ministry of Finance retained consultants to provide research about how other jurisdictions combat fraud, analysis of the potential range of fraud in Ontario's auto insurance system and advice on the regulation of health-care facilities. FSCO actively supported the AFTF, including chairing its Regulatory Practices Working Group and preparing a status report in June 2012.

In its November 2012 final report, the AFTF said auto insurance fraud was substantial and had a material impact on auto insurance premiums. Estimates of the total amount of fraud ranged from \$768 million to \$1.56 billion in 2010, which amounts to between \$116 and \$236 per average premium paid in Ontario in that year. The AFTF made 38 recommendations that form an integrated anti-fraud strategy focused on prevention, detection, investigation and enforcement, along

with enhanced and clearer regulatory roles and responsibilities.

FSCO and the Ministry of Finance established a joint working group to consider the AFTF recommendations, and action had already been taken to implement several of them. In January 2013, the government announced regulation changes to enhance accountability in the auto insurance sector, and FSCO issued an accompanying bulletin to support these changes. New regulations came into force on June 1, 2013, which, among other things:

- require insurers to provide claimants with all the reasons for which a medical or rehabilitation claim was denied;
- require insurers to itemize expenses in a bi-monthly statement to claimants of medical-rehabilitation benefits paid out on a claimant's behalf;
- increase the role of claimants in preventing fraud by requiring them to confirm their receipt of treatment, goods or other services; and
- make third-party service providers subject to sanctions for overcharging insurers for goods and services, and prohibiting them from asking consumers to sign blank claim forms.

Ontario's 2013 budget proposed to expand and modernize the Superintendent's investigation and enforcement authority (particularly in the area of fraud prevention) and give FSCO authority to license and oversee business practices of health clinics and practitioners who invoice auto insurers. These changes to the Act were proclaimed in August 2013.

In January 2013, FSCO launched a project to internally review closed mediation files to help identify systemic issues that may, in turn, identify patterns of fraudulent behaviour in the mediation system. FSCO told us it was also working with stakeholders to develop a consumer engagement and education strategy, and it launched an anti-fraud hotline in June 2013.

In February 2011, to help streamline the claims-handling process, FSCO made usage of the

industry-created Health Claims for Auto Insurance (HCAI) system mandatory. HCAI is an online database and billing portal to which health-care providers are required to submit billings for injury claims before they are forwarded to insurers for payment. In addition to its role of transferring electronic documents, HCAI is also a source of valuable data with the potential to identify fraudulent patterns among both providers and claimants. The HCAI Anti-Fraud working group piloted three initiatives to develop electronic tools to assist health-care service providers and insurers to identify fraudulent activity in the system.

RATES FILINGS AND APPROVALS

Recommendation 3

To ensure that the Financial Services Commission of Ontario (FSCO) fairly and consistently authorizes auto insurance company premium rate changes while protecting consumers, FSCO should:

- *update and document its policies and procedures for making rate decisions—particularly for applications that differ from its own assessments—and for properly assessing rate changes in light of actual financial solvency concerns of insurance companies;*
- *review what constitutes a reasonable profit margin for insurance companies when approving rate changes, and periodically revise its current assessment to reflect significant changes; and*
- *establish processes for verifying or obtaining assurance that insurers actually charge only the authorized rates.*

Status

FSCO updated its policies and procedures for processing and approving rate applications effective May 2012 and told us it had provided staff training on these new procedures. Rate decisions were based on a defined range that was acceptable when a proposed rate differed from the FSCO actuarial service's assessments. Staff were required to prepare an internal briefing note when a difference

greater than the acceptable range was considered justified. The briefing note was to be reviewed with the Superintendent and the information in it documented in the Rates and Classification Report before the filing could be approved.

In October 2012, FSCO retained a consultant to review the reasonable profit margin rate that had been established for auto insurance rate filings, including a financial assessment and consultation with the auto insurance industry. In the final report, the consultant recommended that FSCO should consider moving to either a five-year or 10-year rolling average for a return-on-equity benchmark rate. In August 2013, FSCO decided that an eight-year rolling average for a return-on-equity benchmark rate would be used going forward. According to FSCO, the new methodology generated an 11% return-on-equity benchmark for 2013. In addition, FSCO adopted another benchmark that assesses the insurer's premium-to-equity ratio that is consistent with federal solvency and capital requirements. FSCO also has begun a review of the feasibility of moving to a return-on-premium approach, which it expects may be relatively more simple and transparent than the return-on-equity benchmark.

Since 2012, FSCO has required that the chief executive officer of an auto insurance company annually attest in writing that it provided auto insurance in Ontario in accordance with approved rates, risk classification systems and underwriting rules. The Act prescribes the many rules of conduct with which these companies must comply in doing their automobile insurance business in Ontario, including having their rates filed with and approved by FSCO.

FSCO implemented a new annual requirement for insurance companies to attest that they had independent audit processes in place to confirm that approved rates were charged by the insurer. These attestations from insurers were due by October 15, 2013. In addition, in spring 2013 FSCO began sending out detailed rate verification questionnaires to auto insurers—some randomly selected and some targeted—covering governance

processes and controls that insurers had put into place to ensure they complied with legislative requirements and FSCO-approved rates. FSCO conducted on-site examinations of insurers during 2012 and 2013, including verification of the degree to which it could rely on the information provided in a company's written confirmation and completed questionnaire, as applicable, and to confirm that identified controls were in place and operating effectively. All insurers were to undergo this scrutiny at least every four years.

DISPUTE RESOLUTION SERVICES

Recommendation 4

To ensure that the Financial Services Commission of Ontario meets its mandate to provide fair, timely, accessible, and cost-effective processes for resolving disputes over statutory accident benefits, it should:

- *improve its information-gathering to help explain why almost half of all injury claimants seek mediation, as well as how disputes are resolved, and to identify possible systemic problems with its SABS benefits policies that can be changed or clarified to help prevent disputes; and*
- *establish an action plan and timetable for reducing its current and growing backlog to a point where it can provide mediation services in a timely manner in accordance with legislation and established service standards.*

Status

The government announced in its 2012 and 2013 Budgets that a review of the auto insurance dispute resolution system would take place. At the time of our follow-up, FSCO was completing an internal examination on closed mediation cases and the corresponding insurers' claims files to gather information on the reasons for the high number of claimants who were seeking mediation and how these disputes were resolved. The results of the examination were to be used for the review and for stakeholder consultations to help identify any

systemic issues that were creating disputes with the current SABS legislation and policy. In August 2013, the government announced the appointment of an expert to undertake the review and make recommendations on transforming the current system. An interim report was due in fall 2013 and a final report by the end of February 2014.

To address FSCO's growing backlog of cases involving disputes between insurers and claimants on the payment of statutory accident benefits, Treasury Board approved in December 2011 FSCO's request for an additional \$38.2 million over three years to hire a private dispute-resolution service provider to supplement FSCO's own staff. According to FSCO, backlogged mediation cases were being assigned to the service provider at the rate of 2,000 files per month. New applications received on or after November 29, 2012, were being assigned to FSCO mediators within a couple of days. On March 31, 2012, there were about 29,000 cases awaiting assignment. With this contract help, and with new software that has made mediation scheduling more efficient, all mediation files had been assigned as of August 19, 2013, and the backlog had been eliminated.

In addition, FSCO had experienced a decrease in the number of applications for mediation received each month. In 2012/13, FSCO received approximately 25,300 new applications for mediation, a 29% decrease from the 35,700 applications received in 2011/12. FSCO indicated that this decrease was likely due to the September 2010 legislative changes to the SABS that helped reduce the number of disputes, as well as the auto insurance industry's increased focus on fraud. FSCO informed us that with the decreased volume and the reduced backlog, mediators could handle new cases within the prescribed 60-day time limit.

PERFORMANCE MEASURES

Recommendation 5

In order to provide the public, consumers, stakeholders, and insurers with meaningful information on its

auto insurance oversight and regulatory activities, the Financial Services Commission of Ontario should report timely information on its performance, including outcome-based measures and targets that more appropriately represent its key regulatory activities and results.

Status

During the 2012/13 fiscal year, FSCO finalized its corporate Performance Management Framework that details for each of its divisions, including auto insurance, a set of performance measures and targets that link to its long-term goals and strategic priorities. For example, FSCO's auto insurance performance measures include targets for industry compliance with SABS benefits and approved automobile insurance premium rates. We were advised that the system has been modified to track the data needed for reporting on the performance measures, and that FSCO would report on the measures for the 2013/14 fiscal year in its annual report. The Performance Management Framework was posted on FSCO's website.

In addition, in June 2012, FSCO posted on its website new standards for its turnaround time for approving insurers' filings for private passenger auto insurance rates and risk classification changes. The performance results for 2012/13 were posted on the FSCO website in June 2013.

As of July 2013, FSCO continued to experience delays in releasing its annual report to the public, and the latest annual report available to the public was for the 2009/10 fiscal year. FSCO advised us that the 2010/11 and 2011/12 annual reports were submitted to the Minister of Finance, tabled in the Legislature by the Minister on October 3, 2013, and published on FSCO's website that same month. It also noted that it had made changes to its internal processes and it expected the 2012/13 annual report to be delivered to the Minister by November 29, 2013.

Under its enabling legislation, FSCO is required to publish by June 30 of each year a Statement of Priorities setting out its proposed priorities and

planned initiatives for the coming year, and the reasons for adopting these priorities. The Statement of Priorities includes a report-back section listing FSCO's key accomplishments in the previous year. We noted that the statement for 2013 was available on its website and included the key auto insurance reforms FSCO was working on, including efforts to increase oversight of insurers, reduce fraud in the industry, control claims costs and premiums, and resolve statutory accident benefit disputes backlogs.

MOTOR VEHICLE ACCIDENT CLAIMS FUND UNFUNDED LIABILITY

Recommendation 6

To ensure that the Motor Vehicle Accident Claims Fund (Fund) is sustainable over the long term and able to meet its future financial obligations, the Financial Services Commission of Ontario should establish a strategy and timetable for eliminating the Fund's growing unfunded liability over a reasonable time period and seek government approval to implement this plan.

Status

We were advised by FSCO that, while no changes had been made to address the unfunded liability of the Fund, FSCO continues to formally monitor the status of the Fund, and ongoing Ontario automobile insurance reforms have had a positive impact on the Fund's unfunded liability. The Fund's actuarial report shows that the unfunded liability was about \$99 million as of March 31, 2013, or about \$10 million less than at March 31, 2011. FSCO's consulting actuary recently estimated that the Fund will have sufficient funds to meet its financial obligations through to the 2020/21 fiscal year. The updated cash-flow analysis was completed in fall 2013, following a recent legal decision that will affect the collectability of accounts receivable owed by

bankrupt debtors. FSCO noted that any changes to funding would require amendments to regulations and to the existing Motor Vehicle Accident Claims Fund fee on issue or renewal of an Ontario driver's licence, which are the responsibilities of the Ministry of Finance and the Ministry of Transportation.

OTHER MATTER

Assessment of Health-system Costs

Recommendation 7

In view of the fact that it has been five years since the last review of the assessment of health-system costs owed by the auto insurance sector despite the significant increase in health-care costs related to automobile accidents over the same period, the Financial Services Commission of Ontario should work with the Ministry of Finance, the Ministry of Health and Long-Term Care, and the insurance industry to review the adequacy of the current assessment amount.

Status

The *Insurance Act* requires all automobile insurers operating in Ontario to pay an annual "assessment of health-system costs" to recover the costs to the province of providing medical care to people injured in motor-vehicle accidents. FSCO is responsible for collecting the assessment from insurers, with each insurer paying a pro-rated share of the total. The assessment has not been changed since 2006, when it was set at \$142 million, even though, as we reported in 2011, overall health-care spending and medically related SABS benefits costs substantially increased since 2006.

We were advised that the Ministry of Finance is undertaking to review the current assessment amount, as noted in the Minister's August 24, 2013, policy statement.