

MEMORANDUM

To: All Fellows, Affiliates, Associates, and Correspondents of the Canadian Institute of Actuaries and other interested parties

From: Single Topic Task Force on Risk Classification
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Date: November 23, 2017

Subject: Notice of Intent – Level 2 CIA Public Statement on Risk Classification

Comment Deadline: December 14, 2017

Document 217118

Introduction

In December 2016, the CIA Board approved the topic of risk classification for the development of a level-2 CIA public statement.

The goals of this statement are to demystify the use of risk classification in insurance for the general public, and identify potential unintended consequences of restricting its use for policymakers. This notice of intent (NOI) sets out the proposed direction and content of the public statement.

Issues

Risk classification—the grouping of risks with similar risk characteristics for the purpose of setting prices—is an essential part of a sustainable, fair, and equitable voluntary insurance system. Differentiating among various risks is an effective way to ensure that purchasers of insurance are charged an appropriate amount to transfer that risk to an insurer and promote the stability of insurance systems. Recent developments, though, have given rise to a number of interesting issues in this area:

- The European Union no longer allows sex to be used as a differentiating factor when setting insurance rates, for both life and property and casualty (P&C) coverages;
- The availability of detailed, personal data from advanced technologies—in particular, genetic testing, wearable devices, and vehicle telematics devices—is creating new sets of challenges;
- Privacy concerns around the sharing of information have the potential to create an asymmetry of information and possible anti-selection; and

- The use of credit scores as a rating factor, while having predictive value, may also be perceived as being unfairly biased against certain socio-economic classes.

For historical reasons, and due to the issues listed above, a number of misconceptions about risk classification and insurance exist in the mind of the public:

- Limited understanding of the concept of risk classification, which may also lead to conflict with public perceptions of fairness and justice;
- Policy owners may not understand why incurring a claim on their policy may lead to a higher insurance cost going forward;
- There is a perception that all risks should be insurable, regardless of pre-existing conditions; and
- The effect of anti-selection and the need to control it are not well understood.

This CIA public statement will attempt to dispel many of the myths that surround risk classification as it relates to the pricing of insurance coverages, and educate the public on issues such as anti-selection and risk pooling, eventually leading to a better understanding of the insurance system and how it needs to be effectively managed.

The issues may be different between voluntary and compulsory insurance. Compulsory insurance cannot be subject to anti-selection, nor are pre-existing conditions relevant. Some insurance is compulsory because of legislation; for example, employment insurance and life insurance under [the](#) Canada Pension Plan (CPP). Some group insurance is compulsory for all in an employment class due to a management decision or a collective agreement. For some insurance, such as liability insurance for automobile owners, it may be compulsory to be insured, but the market still operates very similarly to a voluntary system. The public statement will give most attention to voluntary insurance.

Key Components

This public statement will serve as an informational and educational piece for the general public, outlining the importance of risk classification in an insurance environment, dispelling myths about rate-setting practices, and explaining why differentiation is a necessary component.

Issues for consideration

1. Provide an overview of the concept of risk—what it is, and why insurance arrangements are an effective way to control it. Also explain the collective nature of insurance, and why insurance provides an important social benefit.
2. The term discrimination has become generally accepted to mean “unfair discrimination”. This statement will address why “fair discrimination”, or “differentiation”, is necessary to maintain equity.
3. Review current issues in insurance risk classification, and offer opinions on which developments have merit and which ~~ones~~ should be avoided.

4. Provide an explanation on the concepts of risk transfer and risk pooling.
5. Provide examples of restrictions that have been used by policymakers, and the consequences—positive and negative—of doing so.
6. Briefly address the topic of genetic testing, and how asymmetry of information can be costly to all users of insurance¹.
7. Explain concepts such as anti-selection and how a lack of proper management can have a detrimental effect on the insurance system. Discuss how risky behaviours carry a cost.
8. Discuss the predictive nature of risk classification within insurance pricing—what can be anticipated and what cannot (i.e., randomness).
9. Outline and address the myths that exist when it comes to insurance. Specifically, address the misconceptions around the setting of insurance prices, and how the purpose of insurance can be misconstrued by consumers.
10. Discuss the nature of subsidies, and how these are affected by compulsory vs. voluntary insurance arrangements.
11. Discuss the differences between correlation and causality as they pertain to insurance risk classification.

Development and Approval Process

The Public Statements Committee (PSC) will ensure that the development of this public statement conforms to the [Policy on the Approval of Public Statements](#).

In the new policy, a level-2 public statement requires member input and Board ratification prior to its release. Member input will be gathered and considered through the following steps during the development of a level-2 public statement:

- A notice of intent (NOI) will be circulated to members, with a minimum of 14 days given to provide comments. Input received at this stage will help guide the development of a complete first draft.
- A draft statement will be circulated to members with a 30-day comment period. A summary of the input received on the NOI, as well as how it was addressed will be included. There will be a public hearing (likely a webcast) during the comment period. The input received at this second stage will be reviewed closely and considered by the drafting entity.
- The Single Topic Task Force (STTF) will then refine the document and send it to the PSC for approval and then to the CIA Board for ratification. The final statement will be sent to members prior to its external release.

¹ This topic was also addressed in the CIA's 2014 Statement on Genetic Testing and Insurance.

Single Topic Task Force

The CIA Board approved the members of the STTF in August 2017, which shall serve as the drafting entity. Members of the STTF include the following:

Name	Employer	Specific Role
Emile Elefteriadis, FCIA	Swiss Re	Co-champion
Matthew Buchalter, FCIA	Economical Insurance	Co-champion
Christopher Cooney, FCIA	TD Insurance	
Blake Hill, FCIA	Manulife	
Bob Howard, FCIA	Self	

The STTF will also source a team of interested parties to review drafts of the public statement as they are produced.

Proposed Timeline

A first formal draft will be circulated to members for comment before April 2018, with a webcast to follow within four weeks of that release. A revised complete draft will be released before the CIA's 2018 Annual Meeting, where it will be discussed in a session at that meeting. The STTF will also work with the CIA Communications and Public Affairs Department to develop infographics and other materials to accompany the final version.

Member Feedback

Member feedback on the development of this public position statement is very important. Comments to the STTF are invited by **December 14, 2017** and may be submitted by e-mail to RiskClassificationPublicStatement@cia-ica.ca. No other forums for obtaining feedback on this NOI are contemplated at this time.

Due process has been followed in the preparation of this NOI.

EE, MB