Facility Association

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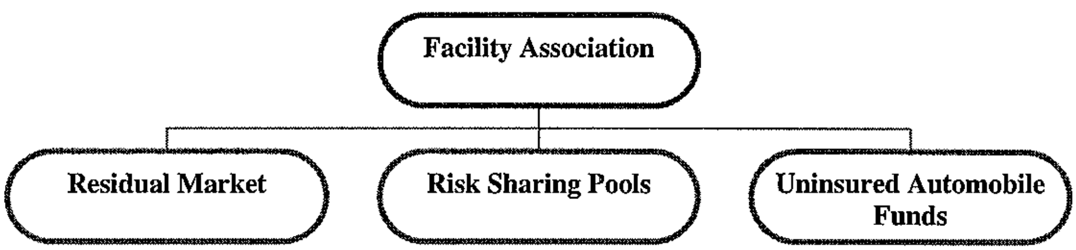
Facility Association

The Facility Association is a Canadian entity whose goal is to ensure that automobile insurance is available for every owner and licensed driver of motor vehicles who require it to legally operate their vehicles. The insurance industry created the Facility Association in June 1977 as an unincorporated, non-profit organization whose role is to administer the involuntary residual market of automobile insurance on behalf of the voluntary/private sector automobile insurance industry across Canada.

Every insurer licensed to write automobile liability insurance in any jurisdictions served by the Facility Association must become and remain a member of this organization. The Facility Association currently operates in the following provinces and territories: Alberta, New Brunswick, Newfoundland & Labrador, Northwest Territories, Nova Scotia, Nunavut, Ontario, Prince Edward Island, and Yukon. The only provinces in which it does not operate are the three provinces with provincial public automobile insurance (i.e., British Columbia, Manitoba and Saskatchewan) and Quebec.

Organization

The Facility Association, which also operates in Alberta under the name of "Market Availability Plan," accomplishes its mission of ensuring automobile insurance availability through two types of risk sharing mechanisms: risk sharing pools and the more traditional residual market. It also administers the Uninsured Automobile Funds in the four Atlantic Provinces as required by the respective provincial Insurance Acts.



In Quebec, the Groupement des Assureurs Automobiles (GAA) administers a risk sharing pool mechanism called the Plan de Repartition des Risques (P.R.R.) which essentially fulfills the same role as for those administered by the Facility Association in other provinces.

Facility Association Residual Market (FARM)

The FARM provides a residual automobile insurance market for owners and operators of personal and commercial motor vehicles who may otherwise have difficulty obtaining automobile insurance. It operates in all jurisdictions served by the Facility Association.

In each jurisdiction, the Facility Association contracts with a few member automobile insurance companies to issue and administer policies. These insurance companies, known as Servicing Carriers, also adjust claims on behalf of the Facility Association.

All policies written by the FARM through a Servicing Carrier are subject to the rates, rules, and classification of the Facility Association. These rates, rules, and classification require regulatory approval for all jurisdictions served by the FARM.

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Under the FARM, agents and brokers who are unable to find automobile insurance coverage for one of their clients can contact a Servicing Carrier who will issue a Facility Association policy for the particular client. As a result, every policyholder insured through the FARM knows that their insurance policy is part of the residual market.

It is important to note that the Facility Association only allows Servicing Carriers to underwrite policies under its FARM mechanism if the policy includes at least the statutory minimum automobile coverage in the jurisdiction concerned and the particular risk is a "Residual Market Risk." In all other cases, the agent or broker must place the risk with their voluntary insurance markets. The Facility Association's Plan of Operation defines a Residual Market Risk as a risk which includes coverage in connection with:

1) any motor vehicle that is not a Private Passenger Vehicle; or

2) any Private Passenger Vehicle with respect to which an insurer to whom an application has been made to insure the risk is authorized at law to decline to issue or refuse to renew a contract of insurance in respect of such risk.

The financial results of the vehicles insured through the FARM are pooled among all insurance companies licensed to write automobile insurance in the province based on participation ratios described below. This is due to the fact that every insurance company licensed to write automobile insurance in a jurisdiction served by the FARM is required by law to belong to the Facility Association.

Risk Sharing Pools

The risk sharing pools allow automobile insurance companies to transfer certain of their personal automobile insurance exposures to an industry-wide pool. While these exposures do not qualify for the FARM, insurance companies believe that they represent a higher risk of loss. As such, risk sharing pools essentially act as industry-wide reinsurance mechanisms that are largely invisible to both consumers and intermediaries.

The Facility Association administers risk sharing pools in Ontario, Alberta, New Brunswick, and Nova Scotia. In each of these jurisdictions, member companies underwrite individual policies according to their own rates and rules. They then have the option of keeping such business for their own account or transferring it to the risk sharing pool based on certain minimum requirements. However, the act of transferring a specific risk to a particular risk sharing pool must be invisible to both the consumer and the insurance intermediary.

Similar to the FARM, the financial results of the risk sharing pools are pooled among all insurance companies licensed to write automobile insurance in the province, who are required by law to belong to the Facility Association.

<u>The Uninsured Automobile Funds</u>

In the four Atlantic Provinces (i.e., New Brunswick, Newfoundland & Labrador, Nova Scotia, and Prince Edward Island), the Facility Association also administers funds which provides financial compensation for damages to persons who cannot obtain satisfaction for their damages under a contract of automobile insurance and where there is no other insurance or where the other insurance is inadequate with respect to the damages claimed. The respective provincial Insurance Acts govern the payment of these claims.

The Facility Association monitors the investigation, defense and final settlement of these claims through the assistance of designated law firms and insurance companies.

Board of Directors and membership rights

The Board of Directors, composed of elected or appointed representatives from member insurance companies as well as insurance brokers, manages and controls the affairs and business of the Facility Association. The Board has the authority to implement many key decisions on behalf of the Facility Association. Some examples of these responsibilities, which are explained in further details in Facility Association's Plan of Operation, are:

— Considering and approving suggested rate changes and rate filings

— Authorizing expenses

— Establishing and maintaining standards to be followed by Servicing Carriers and members using a risk sharing pool

— Appointing committees and sub-committees to assist them with specific issues

As mentioned above, every insurer licensed to write automobile liability insurance in any jurisdiction in which the Facility Association is qualified to operate is required to be a member of the Facility Association.

Members of the Facility Association may vote on matters submitted to them by the Board of Directors. A member's total volume of automobile third party liability direct written premiums for the latest available full calendar year in all jurisdictions in which the Facility Association has operated determines the number of votes that it is entitled to. If a particular matter affects a single jurisdiction, then only members operating in such a jurisdiction can cast their votes, and the respective weight of their votes will depend on their premium volume in the jurisdiction.

For more information on the specific rules regarding the Board of Directors and the rights of member companies, please refer to the Facility Association's Plan of Operation.

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Participation Ratios and Sharing

The Facility Association's Plan of Operation lists five classes of business that determine a member's participation in the Facility Association:

1) Private passenger non-fleet non-pool automobile business

2) All automobile business other than that included in (1) or transferred to a risk sharing pool

3) Business transferred to a risk sharing pool other than a pool operated in Alberta, New Brunswick, or Nova Scotia and other than a catastrophic claim fund established to facilitate the payment of Ontario statutory accident benefits claims due from a specified insolvent insurer

4) Business transferred to a risk sharing pool operated in Alberta, New Brunswick, or Nova Scotia

5) All uninsured or unidentified motorist claims and all amounts expended in connection with a pool or catastrophic claim fund established to facilitate the payment of Ontario statutory accident benefits claims due from a specified insolvent insurer

The Facility Association uses each member's participation ratio, which it determines separately for each of the above classes of business, to allocate the profit or loss for the each of the above classes of business at the end of each fiscal year. The basis of determination of the participation ratio varies by jurisdiction. According to the Plan of Operation, the Facility Association must determine the profit or loss separately for each accident year, in each jurisdiction.

Risk Sharing Pools

There are currently five risk sharing pools operating in Canada. The key purpose for each of these pools is to assist the member companies who provide automobile insurance under their normal rates and underwriting rules to certain owners and licensed drivers who represent a higher risk of loss when compared to the company's overall portfolio.

The Facility Association, in its role as the administrator for all five risk sharing pools, dictates through its Plan of Operation the various rules that insurers should follow in order to participate in this risk transfer mechanism. Each of the risk sharing pools operates in one specific jurisdiction, and member companies operating in this jurisdiction can transfer risk into the pool.

It is important to understand that the Facility Association designed the risk sharing pools to promote stability in the marketplace by making it possible for companies to accept risks for which they believe that their prices are not totally adequate. Therefore, the general expectation is that risk sharing pools, by their very nature, will operate on an overall basis at a financial loss.

Every company shares in the financial results of a particular pool based on a participation ratio determined using a proportion of their total voluntary private passenger, non-fleet, third party liability direct earned exposures (car years) that is not ceded to a risk sharing pool for the applicable province. For Ontario, the participation ratio also depends on the number of risks ceded to the risk sharing pool. (Please refer to the Facility Association's Plan of Operation for more details on the participation ratios.) As every automobile insurance company licensed to do business in a specific province is required to be a member of the Facility Association, a company who decides not to transfer any of its risks to the risk sharing pool will still be allocated a share of the total financial results of the pool.

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There are five minimum requirements that a risk must meet in order to be eligible for transfer to one of the pools:

1) Each pool accepts only private passenger vehicles.

2) A residual market risk should be insured through the FARM and is therefore not eligible to for the risk sharing pools.

3) Each risk transferred into the pool should carry at least the minimum third party liability statutory limit required in the applicable province.

4) The member company must follow the appropriate classification and rating procedures and have requested all appropriate documentation.

5) The premiums charged for the insurance transferable to the pool must be the approved premiums for such a risk.

For each of the risks transferred, it is up to the member company who performs the underwriting to provide the coverages and limits that it finds appropriate for such a risk. However, each of the pools has specific limitations that define the proportion of each eligible risk that can be transferred to the pool. There are also limitations on the transfer of certain coverages (e.g., maximum limits or minimum deductibles). Member companies who decide to offer higher limits or lower deductibles must therefore carry the excess coverages on their own accounts.

One other common requirement for the pools' operations relates to the actual transfer of premiums. For each risk, the transfer premium should be the premium actually charged by the insurance company for the applicable limit or deductible, net of premium payment service charges charged to the insured. The member company will then receive a percentage of the transferred written premium as an expense allowance to settle all incurred expenses including acquisition, operating and loss adjustment costs but not including premium tax and professional fees.

Finally, for each of the pools with specific restrictions on the total allowable transfer from each member company, the transfer limits are a percentage of the voluntary private passenger non-fleet third party liability direct written car years for the applicable province in the immediate preceding calendar year.

Ontario Risk Sharing Pool

The Facility Association established the Ontario Risk Sharing Pool in 1993. It was the first automobile risk sharing pool in Canada. This pool assumes business from Ontario member companies for Ontario risks only, subject to the minimum transfer requirements listed above.

One difference for the Ontario Pool is that the pool only covers 85% of every risk transferred while the remaining 15% stays in the account of the member company. All other pools cover 100% of the risks transferred, subject to the applicable maximum limits and minimum deductibles for the coverages provided.

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To ensure that the Ontario Risk Sharing Pool does not serve as a marketing tool by member companies, the Facility Association has set the maximum total allowable transfer to 5% of the member's voluntary private passenger non-fleet written exposures.

Alberta Risk Sharing Pool

The Facility Association administers two risk sharing pools in Alberta: a "Grid Pool" and a "Non-Grid Pool". Both of these pools commenced operations on October 1, 2004 and assume business from Alberta member companies for Alberta risks only. One of the main differences between the two pools is the number of risks that companies may transfer to each.

The "Grid Pool" allows Alberta automobile insurance companies to transfer into the pool their private passenger insurance exposures that are subject to the statutory maximum premium. There is no limit to the number of risks that a member company can transfer into the Alberta "Grid Pool". This is based on the philosophy that the law requires insurance companies operating in Alberta to accept risks for which they have no control over price, resulting in little to no control over the financial results for this particular book of business.

The "Non-Grid Pool" is similar to the Ontario Risk Sharing Pool. It allows member companies to transfer to the pool any eligible private passenger automobile insurance exposure they underwrite which exhibits higher risk characteristics. However, the Facility Association has set the maximum total allowable transfer to 4% of the member's voluntary private passenger, non-fleet, written exposures that are not transferred to the Grid Pool. The purpose of the Non-Grid Pool is to help companies cope with the "take all-comers" environment in Alberta.

New Brunswick Risk Sharing Pool

The New Brunswick "First Chance" Risk Sharing Pool commenced operations on January 1, 2005. This pool assumes business from New Brunswick member companies for New Brunswick risks only, subject to the minimum transfer requirements previously described.

The New Brunswick Risk Sharing Pool provides a means for New Brunswick insurers to transfer private passenger automobile insurance exposures for which at least one household member is entitled to receive the "recently licensed drivers with good driving records" discount (also called the "First Chance" discount).

Similar to the Ontario Risk Sharing Pool and the Alberta Non-Grid Pool, the Facility Association set a maximum total allowable transfer of 8% of the member's voluntary private passenger, non-fleet, written exposures for insurers participating in this pool.

Nova Scotia Risk Sharing Pool

The "Inexperienced Driver" Risk Sharing Pool is the most recent pool created by the Facility Association. It commenced operations on January 1, 2007. This pool assumes business from Nova Scotia member companies for Nova Scotia risks only.

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The key characteristic of this pool is that it is designed to accommodate inexperienced drivers with good driving experience. Therefore, in addition to the minimum transfer requirements listed above, companies can only transfer risks for which at least one household member is a driver with less than six years of driving experience and who did not have any accidents or convictions over that period.

Similar to the Alberta Grid Pool, there is no limit to the number of risks transferred by members to the Nova Scotia Risk Sharing Pool.

Conclusion

The Facility Association is an organization that was created by and for the Canadian insurance industry. It serves a very important role in ensuring the availability of automobile insurance coverage for Canadian drivers. This study note summarizes some of the key elements of the operations of this organization. For further information and details regarding the topics covered above, please refer to the Facility Association's Plan of Operation.