THE CANADIAN MERIT RATING PLAN FOR INDIVIDUAL AUTOMOBILE RISKS

BY

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The practise of merit rating individual automobile risks is now in its sixth year of successful operation in Canada.

Merit rating of individual automobile risks is not new for it has been used successfully in the British Isles and in some European countries for many years. In North America it has been tried under various circumstances; however, only in Canada has the programme become almost universal, and consequently only here have adequate statistics been produced.

The present Canadian rules read as follows:

PRIVATE PASSENGER AUTOMOBILES— (Except those fleet rated)

In addition to being rated by age of operators and use, individual private passenger automobiles are further rated according to claims experience and driving experience of operators as follows:

A RISKS are those where the following conditions apply:

The Insured and/or principal operator has been licensed in North America or the British Isles or Dominions throughout the past *three years,* and within that period no operator has sustained any accident with any private passenger automobile (whether insurance carried or not) out of which a payment has been made as respects Third Party Liability or Collision or out of which such a claim is pending and there has been no conviction requiring the filing of a Financial Responsibility Certificate.

Note: A Third Party Liability claim does not affect the rating of Collision coverage nor does a Collision loss affect the rating of Third Party Liability. However it should be remembered that uninsured losses do affect rates so that when a policyholder purchases Collision *after* an accident the loss must be charged for in the Collision rating. Collision losses where full recovery is made do not affect the rating.

X RISKS are those where the following condition applies:

The requirements are the same as those for A risks except that the period of licensing and claim free operation is *two years* instead of three.

Y RISKS are those where the following conditions apply:

The requirements are the same as those for A risks except that the period of licensing and claim free operation is *one year* instead of three.

B RISKS are those where one or more of the following conditions apply:

Either some operator has been involved in an accident or has had a conviction within the past *year,* or the Named Insured and/or principal operator has been licensed in North America or the British Isles or Dominions less than the *year* just preceding.

COMMERCIAL AUTOMOBILES — (Except those fleet rated)

A RISKS — Commercial risks other than those included in fleets which can qualify under the following conditions:

(a) The insured has owned a similar commercial type automobile throughout the past three years.

(b) Within the past three years no accident has occurred with any such vehicle out of which a payment has been made as respects Third Party Liability or Collision, (whether insurance carried or not), or out of which such a claim is pending and there has been no conviction requiring the filing of a financial responsibility certificate.

Note: If the Insured has owned more than one commercial type automobile for three years, the claim free rate applies separately to the vehicles (including substitutions therefor) which have been owned for three years and which have not been involved in accidents. Third Party Liability accidents do not affect the rating of Collision coverage nor do Collision only accidents affect the rating of Third Party Liability.

X RISKS —

The requirements are the same as those for A risks except that the period of ownership and claim free operation is *two years* instead of three.

Y RISKS —

The requirements are the same as those for A risks except that the period of ownership and claim free operation is *one year* instead of three.

B RISKS —

Commercial automobiles which do not qualify under Class A, X or Y.

I believe that there are still many automobile underwriters in the United States who feel that merit rating of individual automobile risks is not justified because they say there is little credibility in the experience of a single automobile. Experience in Canada has definitely proved that this is not the case. Undoubtedly this is so because automobile accidents are not a matter of pure chance, but are instead a factor of the driving habits of the operators. The Canadian experience is so conclusive that I think it can be said without fear of contradiction that merit rating of individual automobile risks is not only desirable, but necessary if the companies are to spread insurance costs equitably.

It may be of interest to sketch the historical background of automobile merit rating in Canada. It was first tried in the middle 1930's, but because many companies did not follow it, the programme was abandoned. However, by the early 1950's it seemed obvious to underwriters in Canada that it had become necessary to rate individual risks as respects their claim producing record. Thus, in April of 1953 the Canadian Automobile Underwriters introduced the original merit rating programme, and this programme was followed by most independent agency company underwriters. The programme divided risks into two classes, Class A which had no Third Party Liability claims within the past three years, and Class B, those which had produced a claim. A claim was deemed to be one which had involved a payment other than adjusting expenses. The original programme applied only to Third Party Liability, but within a few months it was extended to Collision coverage, and at that time a loss under either Third Party Liability or Collision nullified the preferred rates as respects both coverages. In addition to the claim free requirement, it was required that the insured had owned an automobile for three years. The discount for a Class A Risk was 20%.

The 1953 plan applied only to Class 1 risks, that is pleasure use vehicles without any male operators under 25 years of age. In 1954 the programme was extended to all classes of private passenger automobile risks. Also the ownership requirement was dropped, and instead it was required that the Insured must have had three years' driving experience in North America or the British Isles. Later in 1954 the programme was extended to individual Commercial automobiles. In 1956 Class X was established for those risks which were claim free for two years, but not three. It was also provided that a Third Party Liability claim did not affect the Collision rate, nor a Collision claim the Third Party Liability rate. In 1957 another modification was made, establishing Class Y for those risks which were claim free for one year, but not two. The program thus now provides four classes. The differentials used are 100% for a B Risk, 90% for a Y Risk, 80% for an X Risk, and 65% for an A Risk. Statistics are being produced for each one of the merit rating classes for each one of the five Age and Use classes.

In Canada we have compulsory filing of statistics by all insurers according to a uniform statistical plan. This is done under Government regulation, and consequently complete statistics are available. The latest figures available are those for 1957 policy year developed on an 18 months basis, that is to June 30th, 1958. The number of cars insured varies from over a million and a half for Class 1 for

Third Party Liability to less than twenty thousand for Class 5 for Collision. This exhibit shows the following frequency figures on a countrywide basis:

PRIVATE PASSENGER RISKS— CLASS 1 — Pleasure Use, no male operators under age 25.

	THIRD PARTY LIABILITY			COLLISION— $100 Deductible		
Merit Rating	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*
A	7.8	56%	90%	7.0	59%	93%
X	10.4	74%	121%	8.0	67%	107%
Y	11.7	84%	136%	9.0	76%	120%
B	14.0	100%	163%	11.9	100%	159%
Combined	8.6	61%	100%	7.5	63%	100%

PRIVATE PASSENGER RISKS — CLASS 2 — Pleasure use, non-principal male operator under age 25.

	THIRD PARTY LIABILITY			COLLISION— $100 Deductible		
Merit Rating	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*
A	12.1	74%	93%	10.8	87%	97%
X	15.0	92%	115%	13.5	109%	122%
Y	15.4	95%	118%	13.3	107%	120%
B	16.3	100%	125%	12.4	100%	
Combined	13.0	80%	100%	11.1		100%

Note:—The difference from Class 1 in relative frequency may be due to the fact that risks with 16 year old and other *new* under age drivers have been allowed A rating.

PRIVATE PASSENGER RISKS — CLASS 3 — BUSINESS USE

	THIRD PARTY LIABILITY			COLLISION— $100 Deductible		
Merit Rating	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*
A	12.7	64%	90%	9.8	67%	92%
X	16.8	84%	119%	12.3	84%	115%
Y	17.3	87%	123%	12.3	84%	115%
B	19.9	100%	141%	14.6	100%	136%
Combined	14.1	71%	100%	10.7	73%	100%

PRIVATE PASSENGER RISKS — CLASS 4 — Unmarried Principal male operator under age 25.

	THIRD PARTY LIABILITY			COLLISION— $100 Deductible		
Merit Rating	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*
A	15.1	71%	85%	18.4	90%	98%
X	18.4	86%	103%	17.2	84%	92%
Y	17.0	80%	96%	17.7	86%	95%
B	21.3	100%	120%	20.5	100%	110%
Combined	17.8	83%	100%	18.7	91%	100%

Note:—This class would probably show relative frequencies closer to Class 1 if there was a three year ownership requirement for A rating.

PRIVATE PASSENGER RISKS — CLASS 5 — Married Principal male operator under age 25.

	THIRD PARTY LIABILITY			COLLISION— $100 Deductible		
Merit Rating	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*
A	10.3	70%	94%	16.2	86%	100%
X	11.5	78%	105%	14.0	74%	86%
Y	12.1	82%	111%	11.5	61%	71%
B	14.7	100%	135%	18.8	100%	116%
Combined	10.9	74%	100%	16.2	86%	100%

COMMERCIAL RISKS — ALL TYPES COMBINED

	THIRD PARTY LIABILITY			COLLISION— $100 Deductible		
Merit Rating	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*	*Claim Frequency*	*% of B Frequency*	*% of Combined Frequency*
A	8.2	40%	78%			
X	13.9	68%				
Y	15.2	74%			NOT AVAILABLE	
B	20.5	100%				
Combined	10.5	51%	100%			

Note:—The figures are for ***all classes combined,*** and the higher normal frequency on heavy trucks probably makes Class B results appear more unsatisfactory than they actually would be if experience were available separately by type of commercial vehicle.

The actual experience is somewhat at variance with the percentage being used in the rating and the relativity used is somewhat inaccurate. No doubt the formula will be amended some time in the near future. However, it is obvious that the principle is sound, and that those risks which have produced claims are much more likely to have further losses than those which are claim free. A Class 1 risk which has been claim free for three years is only 56% as apt to have a claim within the next year as a risk which has produced a claim during the immediate preceding year. Risks with a claim free period of one or two years are better to an intermediate degree. It can be argued that risks with four year and five year claim free periods are better than those with only three and perhaps something will be done to increase the discounts for longer claim free periods. Added difficulty arises in the disclosure of claims as the period is extended and although this is not insurmountable, there is a limit to the length of experience period which it is practical to use.

The advantages of the merit rating system offset the minor disadvantages and difficulties that exist in the application of the plan. To begin with, it permits a low rate for the select risk, and that is what the insuring public demands. The man who has a good record resents paying the same rate as the man who is constantly having losses. It also provides the companies with a rate which will carry the risk of those insureds who have had claims. This does not mean, of course, that there are not risks which are completely unacceptable because of their severity and frequency of losses, and such risks are probably properly written only in an Assigned Risk Plan. It does provide a rate which is sufficient to carry measurably substandard automobile risks.

The worst problem in a merit rating plan is that the companies are under constant pressure to forget small losses and this pressure must be ignored if the plan is to be successful. At first we had a great deal of difficulty but now the insuring public has accepted the system and are paying small property damage claims themselves in order to protect their merit rating. The effect is that of a deductible coverage and the companies are benefiting by reduced claim adjustment expenses.

With a merit rating programme it is essential that automobile applications and automobile policies state clearly the claims record of the risk. We have always had such a statutory requirement in Canada, and consequently this does not present a problem to us. Also a record of losses must be maintained on the company's copy of the policy so that the proper rates can be applied on renewal. On new business there is probably some inaccuracy in the reporting of losses, but we do not find it of major importance. Few people are willing to jeopardize their insurance by making a deliberately false statement.

To summarize, the Canadian experience indicates that merit rating of individual automobile risks is not only desirable, but practical. It is actuarially sound and is popular with the great segment of the insuring public who have few, if any, claims. The system keeps rates lower on good business and provides higher rates for the less satisfactory driver. The practical problems are not too difficult and the cost of making the system work is not excessive. A rating plan that does all these things is undoubtedly worthwhile, and represents a real advance over a plan which ignores the claim record of individual risks. In Canada, automobile underwriters generally would not wish to operate without the merit rating plan.