

November 15, 2021

Financial Services Regulatory Authority of Ontario
25 Sheppard Avenue West, Suite 100
Toronto, ON
M2N 6S6

Dear Sir/Madame.

Consultation ID: 2021-017

All Together Now: FSRA, the Innovation Office, and an Innovation Framework for a More Innovative Ontario Financial Services Sector

Thank you for providing this opportunity to comment on the recently published Innovation Framework Consultation.

I am writing on behalf of the Ontario Mutual Insurance Association. We are the trade association for 37 provincially incorporated mutual insurers. Our Association was established in 1882 and our member companies are all over 100 years old having operated in their communities for over a century.

Our members distribute their property-casualty products through both brokers and agents.

Our members, as Ontario chartered property casualty insurers, provide farm, home, auto, and commercial coverages to individuals and businesses across the province.

We are providing our preliminary remarks based on the questions outlined in the consultation paper. With that in mind, the consultation paper has undertaken the difficult challenge of attempting to bridge industry innovation with practical regulation and some of the questions asked truly won't be fully addressed in a conceptual framework environment. This is not offered as a negative observation, but rather as a reflection of our member companies relatively straightforward and hands-on approach to many of the issues under discussion.

We believe that a consultation on this general framework is welcome, and time well spent at the outset of a new approach.

For context on our responses to the questions that follow, our member companies are solely engaged in the provision of property-casualty insurance and are all considered smaller enterprises in the overall sector.

In some cases, our comments may reflect observations relating to broader innovation concepts, but for the most part our thinking is largely based on our core focus on policyholders and our concentrated business model within the property-casualty sector.

What does successful innovation look like?

Financial services by their nature tend to be conservative and risk averse. The consequences of failure for financial services organizations are profound, as can be seen when business cycles wax and wane. Innovation itself entails risk. To some degree the relatively slow pace of innovation thinking in the financial services sector has been fostered by risk aversion, including reputational risk, to all stakeholders including regulators.

That being said we will note three themes that we believe successful innovation might entail.

1. We believe that the principle of transparency should be embedded in the innovation process and the regulatory oversight process. That includes transparency on the practical implications of innovation, but we also believe that there is an expectation for transparency on the motivation for any innovation being introduced. This includes answering the question as to why it's good for consumers, but we believe it should also include an indication as to why the innovation is important to the entity and the potential gains the innovating entity hopes to see from the innovation.
2. We believe that successful innovation should incorporate a degree of simplicity. This may include increased simplicity to the consumer. Many of OMIA's members are small enterprises and much of their innovation may often look like innovation by "iteration". In other words, small, simple steps toward a longer-term goal. We believe that successful innovation should be reasonably simple, incorporate plain language, and allow for relatively easy understanding for all stakeholders. Recent discussions on market conduct issues arising from the sale of auto insurance, have underlined the problems that can arise when innovation and technology are too complex to be fully examined for negative impact to the consumer.
3. We believe that the property-casualty insurance industry has shown an ability to work together for the common good of consumers in the past. We have also seen examples where a more open-source approach to developing some products and market needs would probably have achieved results both more quickly and more effectively for consumers. As an example, the introduction of flood coverage to residential policies several years ago was seen to be a critical public service and public policy element but consumers probably would have benefited from greater collaboration on key elements of flood coverage being introduced.

In support of each of the three points noted above we believe that successful innovation while providing a consumer benefit should also do so in such a way that the innovating entity is not burdened with onerous and ongoing reporting that does not create value to the consumer nor to the reporting entity.

What role do the sectors want to see FSRA play in facilitating innovation?

We agree with the concept stated in the approach paper that FSRA is not to be the innovator but rather create an environment where innovation can be conducted effectively and efficiently while maintaining consumer "safety".

We believe that FSRA should always consider the maintenance of stability in the marketplace versus the potential disruption of innovation. Property-casualty insurance needs to be a stable long-term and available product. Instability in the property-casualty market as we have seen during the pandemic "hard market" creates public mistrust and economic hardship. FSRA needs to be the voice balancing stability versus disruption.

FSRA will also need to create a balance between its role as a prudential regulator and a market conduct regulator.

As our member companies are prudentially supervised by FSRA we have particular insight into the expectations regarding risk management and solvency. We believe it's critical that FSRA create a more seamless perspective between its own departments as related to risk versus innovation. In a similar fashion, the particular risks identified by FSRA's Market Conduct branch will also need to be fully seamless with the introduction new products, pricing, or methodologies.

We believe that the approach paper clearly sets out FSRA's role in oversight versus direction and we would note that directive behavior from the regulator would seem inappropriate. Nonetheless, there may be times when the regulator has to be unambiguous to the degree that it may seem somewhat directive.

FSRA's role also needs to incorporate clear communication channels both within FSRA and with a unified voice from FSRA to other stakeholders.

In order to fulfil this role we believe that FSRA will need to also take positions on the degree to which innovation takes place on the "fringes" of the P&C sector versus the "foundational" elements of the sector. This ties back to comments on stability and availability and the need to differentiate on where innovation risk might have an impact.

As a final point, we believe that FSRA's success in achieving its role must incorporate an in-depth understanding of the sector and all the stakeholders and an ability to convey that understanding through good decisions and clear communication.

What are your most relevant touchpoints with FSRA on new opportunities and what can be improved facilitating innovation?

For the most part our touch points relating to innovation would relate to relatively minor changes as related to product offerings, compliance issues, and larger changes in the industry such as IFRS-17.

As an example, a mutual wishing to insure drones (unmanned airborne vehicles) needs to get a license extension. While this may not be pure innovation it follows a similar process to at least some degree as the market conduct elements of offering a new product need to be balanced against whatever financial risk goes with that. The ability to coordinate questions relating to both licensing and solvency are important. At any given time we believe that the most important improvement in facilitating innovation is for the innovator to be able to receive a timely and complete response from FSRA as to expectations on next points. This also needs to take place without excessive reporting and administrative hurdles.

Do you see any gaps in our Innovation Process in the development of an innovation opportunity?

In considering the innovation process outline our comments are on a preliminary basis. The ultimate effectiveness of the process will be seen by example. At some point a design must be chosen and tested.

As a general observation we believe that the innovation process needs to consider the organic nature of innovation versus the “process of innovation” versus the administrative needs of regulators and other stakeholders. The ability of the process to recognize these and remove duplication and rework should be an objective.

We also believe that the innovation process needs to be able to recognize key innovation principles such as “failing fast”, the development of “minimal viable products” or “skateboards”, etc. There are many concepts which support the innovation process which in and of themselves do not fall naturally into risk management. As an example the idea of the failing fast with a new idea is not something common to most financial services as reputational risk with any failure can be significant. Nonetheless, as the expectation is that the financial services sector will innovate, the FSRA innovation process needs to balance speed with process.

How useful is the intake questionnaire?

We believe, similar to our comments on process, that a questionnaire simply needs to be used, evaluated, and amended as appropriate. We believe that questionnaires should be scalable based on the level of perceived risk with any particular innovation. The purpose of the questionnaire should also be to capture information essential to moving to the next step and not the creation of an extensive database.

It may be useful to look for opportunities within both the process and questionnaire to eliminate or consolidate pieces that simply don't add value to the outcomes.

Based on our experience we believe that in many cases the request for information can be overly onerous and may be more guided by a one-size-fits-all approach to regulators managing their own risk as opposed to actual risks to the consumer.

How can we successfully appraise and manage risks from innovation?

We believe that the best risk management comes from an ability to deeply understand the business and risk environment where the innovation is proposed. This supports our earlier point on demonstrating an ability to understand all stakeholders to the P&C sector.

Currently, P&C insurers undertake extensive Enterprise Risk Management and Own Risk Solvency assessment which places a dollar in capital value on risk.

As such risk identification, control, and mitigation is already embedded in much of the regulatory process. (It should be noted that some of that process clearly rests with OSFI as federal prudential regulator in some cases.)

As such, we believe that FSRA will need to understand OSFI's approach to risk in assessing innovation risk at the market level.

From an overriding policy standpoint we believe that FSRA must keep in mind the impact of innovation on long-term market and sector diversity and the continuing availability of capital. We believe there is already a very significant risk of over consolidation within the property-casualty underwriting and distribution network. If this trend continues it will not serve consumers well and in fact could eventually result in a P&C market crisis. We believe the overall health of the marketplace needs to be a core consideration.

We believe that in some cases disruptors in other non-financial sector areas have been given a relatively free hand and, in some cases, have simply "innovated" in order to be taken over, leading back to a rapidly consolidating market.

We also believe that issues around privacy and data and transparency on the use of data is a critical risk that innovation must consider. This goes back to our first comment on transparency and the need to ensure that motivations for innovation are aligned.

What are some of the critical innovation opportunities you see in your sectors and where do you see barriers to enabling these innovations?

The property-casualty market in Canada is mature and there are significant barriers to entry created by capital requirements, compliance needs, and regulatory complexity. As such innovation opportunities have typically been within a fairly narrow band including new pricing models, expanded product offerings, and digital connectivity and distribution.

We believe that each of these will be a core innovation opportunity within the sector.

Currently we see a number of barriers to these.

In some cases, a relatively simple innovation like being able to provide an automobile insurance pink slip electronically was delayed well beyond any technical reason by the difficulty in involving multiple provincial Ministries, who all had a specific area of concern to sign off on.

Electronic pink slips were encouraged by FSRA, and yet other ministries had many barriers which prevented it from happening, for an extended period.

Managing those inter-ministerial cross-over areas will be critical to this process.

We also believe that the Canadian legal environment poses challenges given the litigious and adversarial nature of insurance litigation. Class actions and litigation funding have exacerbated this. New entrants to the sector need to understand very carefully what they're getting into from a legal liability standpoint as these issues can damage the reputational risk of the entire sector and multiple stakeholders.

Insurance is also relatively unique in that it has many longtail risks related to casualty covers. This to a large degree goes against the "fail fast" model of innovation given that a "fast" failure may linger for multiple years and business cycles. Automobile insurance is particularly susceptible to this longtail risk including adverse legal development, social inflation, and rising costs. We have seen cases for both first party and third-party claims for damages reopened for new causes of action based on appeal decisions years after the original claim date.

Are the regulatory tools currently available to FSRA sufficient in allowing FSRA to facilitate innovation while protecting the public interest? If not, what else is needed?

In terms of assessing the utility of TLE's and other regulatory tools we believe more detail would be required on the TLE. We also believe that understanding what will be communicated from the TLE's is important.

Do you see any roadblocks to innovators being inclined towards and comfortable with participating in FSRA TLEs?

We believe that the perception of the reporting and administrative burden associated with entering into or operating in a TLE could be a significant barrier.

We also believe that the potential competition laws may make it difficult to innovate further or to have the actual consortiums of P&C insurers move into TLE environments on the understanding of a wider benefit by collaboration. We have noticed a trend recently for greater scrutiny on all potential for anti-competitive behavior. We believe that this is at least partially driven by increasing consolidation in the P&C marketplace and is a natural reaction to that consolidation and the presence of dominant players controlling a significant portion of the marketplace.

A potential remedy to that would be ensuring that the TLE operates in a framework that is well within any competition law requirements.

We also believe at some point in the consideration of the overall innovation environment whether it is TLE's or otherwise some thought should be given to the ability of political pressure on financial services sectors. We've seen repeatedly, and more frequently over the last 20 years the willingness of legislators, perhaps mirroring their US counterparts, in attempting to force sector behavior through grandstanding and public pronouncements for changes that may not be in the best long-term interest of anyone, including consumers. Nonetheless this political pressure can force allocation of resources and attention at any given time. That the potential for TLE's falling within an area where adverse outcomes could be expected due to political pressure should be considered.

Is the proposed fee structure for participation in the TLEs fair?

We believe that FSRA should be extremely careful in ensuring that there is no cross subsidization of innovation by various regulated entities. The cost of regulation should ultimately be borne by innovators where necessary and as a result regulatory involvement should be scaled appropriately as ultimately all of this is passed on to consumers.

What are some meaningful ways the Innovation Office can engage with your sector?

As noted, we represent small property-casualty insurers. Our Association was formed in 1882 at the behest of the Department of Insurance. Throughout our history our experience with "engagement" has been that regulators and the "regulated" need to make a meaningful investment in developing relationships that ensure stakeholders clearly understand the playing field and particularly the anticipated changes to any playing field over the next few years. With FSRA and its predecessor FSCO, we have seen the benefits of plain language communication and both formal and informal discussions. We believe this allows diverse elements of the P&C sector to work best within a highly complex environment.

We also believe that continuing the consultation process is helpful as it does force all parties to think through the implications of potential actions or inaction.

We appreciate the opportunity to provide our comments.

Regards,

A handwritten signature in blue ink that reads "John L. Taylor". The signature is written in a cursive style with a large initial "J" and "T".

John L. Taylor BBA, FCIP, FCLA, CHRL
President