A Revision of the Methodology of the Home Insurance Component of the Consumer Price Index beginning with the February 2008 CPI

Background

The Consumer Price Index (CPI) is the principal source of information concerning trends in consumer prices and inflation in Canada, and is one of the nation's most important economic indicators. The measure is used extensively for economic analysis and policy formulation in both the public and private sectors, and for escalation of contract amounts and other payments among individuals and organizations.[1]

The CPI tracks movements in the pure price change of goods and services in the Canadian marketplace. For example, the homeowners' insurance price index (HIPI) tracks pure price changes in the costs of insuring a home and its contents against loss. Prices for these policies are determined based on two factors: 1) the value of the structure being insured and 2) all of the factors that affect the risk of a loss, such as location, type of heating system and the age of the home. These pure price changes are then increased or decreased, based on the movement of an escalator measured by an index of new housing prices. This accounts for the impact of a consumer's house value on the overall price of their policy. Consumers can observe directly how a change in the value of their home affects their policy when they renew it each year.

The New Method

Although the Canadian CPI conforms to international best practices, some of its underlying concepts and methods are periodically reviewed and updated to ensure that they accurately reflect changes in the economic environment and the behaviour of consumers.[2]The present review of the HIPI is part of a major effort initiated by the CPI program to enhance the concepts, methods and data sources used for the insurance component of the CPI.

The house value escalator currently used for the HIPI is an index of new house prices. In order to better reflect changes in the value of all homes, the HIPI will now be escalated by an index that measures the change in the value of new and existing homes in various regions across Canada. The way in which the new escalator is applied to base insurance premiums will also be changed. In the current method, the house value escalator is used under the assumption that a given change in a house's value results in an equal increase in the price of an insurance policy for that house (For example, that a 1% increase in the value of a house will result in a 1% increase in an insurance policy on that house).

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[1] See Statistics Canada (1996): Your Guide to the Consumer Price Index, Catalogue 62-557-XPB.

[2] The "Consumer Price Index Manual: Theory and Practice" is a joint publication of the United Nations (UN), The World Bank, the Statistical Office of the European Communities (Eurostat), the Organisation for Economic Cooperation and Development (OECD), the International Monetary Fund (IMF) and the International Labour Office (ILO).

Although there is a strong relationship between changes in house values and changes in premium prices, current evidence suggests that this relationship differs by region and insurance carrier across Canada.

In light of this evidence, the HIPI methodology has been modified to account for these differences. Specifically, the new method no longer assumes that there is a one-to-one relationship between changes in house values and changes in premiums. Instead, insurance premiums will be escalated exactly as they would be for a consumer renewing their policy, given a change in the value of their home.

In conjunction with the above changes, the sample for the HIPI has also been significantly expanded. This includes an increase in the number of insurance policies and insurance carriers for which prices are determined, as well as increased regional sample coverage. These changes will ensure that the HIPI is a robust and reliable indicator of changes in the price of homeowners’ insurance for consumers