ICBC 2016 RATE REQUIREMENTS APPLICATION – FINAL ARGUMENTS

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INTRODUCTORY NOTE

On 19 December 2016, the government announced that it had directed the BC Utilities Commission to approve a Basic rate increase of no more than 4.9% by 16 January 2017. My final arguments, which were prepared prior to the latest infringement on the remaining independence of the regulator, should be read in this context.

In the December 19th media announcement, the word affordable was used seven times, as if repeating the mantra would somehow make the wish a reality. While restricting the BC Utilities Commission's independence/desecration, depleting policyholders' capital reserves to suppress rates and hoping for the best might result in some short-term political advantage, it is a poor substitute for a proper re-examination of the current model of providing public automobile insurance in this province.

As the statutorily mandated regulator of Basic insurance, the Commission is rightly concerned about the long-term viability of both the Basic program and the main source of funds provided by the Optional profits. Yet ICBC (and one must presume the government) now says that "the examination of the long-term sustainability of Basic insurance falls outside the Commission's mandate."[1]

This clearly implies that the government sees the Commissions role as expeditiously approving the annual rate submissions while leaving longer-term policy and financial considerations to the real decision makers.

As the Legislature provided the Commission with its original statutory authority to oversee the Basic program, the Commission must reject this limited role and use its unique position to provide the government with advice and recommendations that will strengthen the sustainability of public automobile insurance for the benefit of vehicle owners and drivers in this province.

[1] BCUC, ICBC 2016 RRA, IR 2, BCUC 63.1.

A foolish consistency is the hobgoblin of little minds, adored by little statesmen and philosophers and divines.

Ralph Waldo Emerson

The provincial government's foolish consistency in underpricing ICBC's Basic insurance program has led to a looming crisis for policyholders, and potentially for taxpayers. The 2013 directive to suppress Basic rate changes effectively eliminated the authority of the BC Utilities Commission to regulate the Basic program. The rapid growth in claims costs, combined with low interest rates, has required annual rate increases higher than permitted by the price control formula, and much higher than the actual rate increases requested by ICBC. The rate suppression directive has left the Commission without the desecration to ensure that the Basic program continues to operate with a satisfactory financial condition.

The government's quest for rate stability was quickly doomed to fail as the trend in claims costs began to accelerate at alarming levels in 2013 and again in 2014 and 2015. The resulting deficits in the operating account would have reduced the capital reserve to well below the regulatory minimum, but from 2012 to 2015 the government ordered that the Basic reserve be re-inflated with $936 million of Optional capital.[2]

Unfortunately, the government has persisted with its rate suppression policy by requiring ICBC to request a rate 2016 increase of only 4.9%, well below ICBC's forecast of 15.5% necessary to balance revenue to anticipated expenditures. To keep the capital reserve from falling below the minimum for 2016/17, cabinet again directed ICBC to transfer $472 million of Optional funds to the Basic program.

The rate request still requires the all but perfunctorily approval of the Commission. For the government, the imprudent adherence to the rate suppression policy has the perceived benefit of keeping the true cost of the rapid growth in Basic claims costs from becoming a contentious issue during the run up to the May 2017 election. But the outlook for ICBC's 2017/18 capital reserve creates a dilemma for the Commission because of its previous commitment that the financial stability of the Basic program.

1. BC UTILITES COMMISSION'S REDUCED ROLE[3]

In 2003 the government delegated the regulation of ICBC's compulsory Basic insurance program to the BCUC, in part to ensure that Basic rates would not subsidize the Optional program which was to compete with private sector insurers. The de-politicization of rate-setting extended to BC Hydro, as the Commission resumed regulating the corporation's domestic electricity rates. Cabinet retained authority to issue directives to the Commission to ensure that its decisions conformed to government policy. But, as

[2] By year-end 2015 the Basic capital reserve marginal capital test (MCT) ratio was 118%, a comfortable cushion above the 100% regulatory minimum had the future growth in revenue matched the increase in costs.

[3] For a more complete summary of the government's overt policy to severely restrict or eliminate the BCUC's rate setting authority see .http://www.bcpolicyperspectives.com/blog/posts/government-bc-utilities-commission-independence

Mr. Justice Bauman wrote in 2006, "What the provincial government giveth in the sense of discretionary jurisdiction…is what it may also taketh away."[4]

By the end of the decade, however, the government was becoming frustrated by the independent role exercised by the BCUC. In 2012, when the BCUC appeared to be questioning the growing dependence on deferring costs (which increased the utility's debt), the government ordered the Commission to comply with lower than required rate increases for 2012 and 2013. The same rate suppression policy was evident with respect to ICBC's Basic rates which were under pressure due to rising claims costs. In early 2013, cabinet ordered the BCUC to adopt a price control scheme to limit the annual increase Basic rates.

The operating deficits resulting from the government's deliberate policy of rate suppression increased the debt liability for BC Hydro customers, and reduced the ICBC's capital reserves, which increased the likelihood of a major rate increase for Basic insurance policyholders. Such a rate suppression policy would not be possible where a truly independent regulator, using the cost of service model to set rates, exercised its authority.

The curtailment has continued this year, despite the recommendations of the 2014 Independent Task Force (released in early 2015), which urged the government to refrain from issuing prescriptive directives and allow the Commission to regulate the two utilities. The recommendations included a review of the attributes of independence by Rowland Harrison, who concluded that the government directives had reduced the role of the BCUC to that of an agency of the cabinet.[5] In correspondence with the writer Mr. Harrison wonders whether the BCUC can ever be considered independent when attempting to regulate a Crown corporation. "The regulation of Crown corporations by 'independent' tribunals itself raises questions about independence. These questions are only complicated where the regulator of the Crown asset is also subject to binding direction by the same Crown! The model makes a bit of a mockery of the concept of regulation by a truly independent tribunal."[6]

The government ignored the task force recommendations and has continued to over-ride the Commission's authority, both with ICBC and with BC Hydro, to ensure that the decisions "of a group of unelected bureaucrats and lawyers" do not interfere with what the government decides is good public policy.

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[4] See BCUC, ICBC 2014 RRA, Final Arguments, 2 April, 2015. Bauman was appointed CJ of the Court of Appeal in 2013.

[5] See http://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bcuc_review_final_report_nov_14_final.pdf

[6] Rowland Harrison email to Richard McCandless, 15 December 2016.

The 4.9% rate increase for Basic insurance meets the regulatory requirements that the BCUC must use when assessing its merits; it was developed using accepted actuarial principles (overridden by cabinet direction), it is within the price control band, and it will (in theory) keep the capital reserve ratio above the regulatory minimum level by 31 March 2017.

In attempting to justify the rate suppression policy's curtailment of the BCUC's authority to set Basic rates, ICBC asserted in 2014 that the price control restriction; "enhances the Commission's ability to ensure that rates are relatively stable and predictable."[7] By 2016, however, ICBC was more direct as to the Commission's authority to materially change the rate request: "So in sum, as a result of the regulatory framework for basic rates, the rate indication ultimately approved by the Commission cannot be significantly different from what has been proposed."[8]

For good measure, the August 2016 amendments to SD IC2 eliminated the Commission's authority to set the Basic capital management target, and required the BCUC to continue to assume a 145% ratio for setting rates.

This request, by again ignoring the structural deficit in the Basic rates, is giving ICBC's policyholders a false belief that the finances of the Basic program are being managed. The Commission should use the opportunity of the rate review to take a longer-term perspective highlighting the financial risk of the rate suppression policy, and recommend mitigation strategies to lessen the rate shock faced by Basic policyholders for next year.

2. THE PERILS OF PRICE CONTROL

The BCUC must set the price of Basic insurance based on accepted actuarial practice and has employed the cost of service model to do this. The cost of service model requires that rates be set to achieve sufficient revenue to match forecasted expenditures. The BCUC must also ensure that the price increase keeps the capital reserve from falling below the 100% regulatory minimum.

The price control scheme, besides being contrary to the cost of service model for rate-setting, provides a real temptation for short-term political considerations to take precedence over ensuring the longer-term financial health of the Basic program. Financial health is defined in this analysis as the ability of the Basic program to maintain a capital reserve at the 100% minimum required by regulation, plus a margin to reflect risks specific to the Basic program.

With the 2013 price control directive, the government hoped to moderate annual rate increases by the greater use of the capital reserve. Instead of matching annual revenue to costs, the matching would be done over a longer period. With price controls the government gambled, using policyholders' capital, that shortfalls in one fiscal year, funded by a decline in capital (equity), would be made up in the next year.

Where the pressure on costs is of limited duration a price control scheme can be of value, especially if the capital reserve is too large. The lower price is similar to a rebate to policyholders, albeit with their own capital savings. However, if costs routinely exceed capped rate revenue the system poses a real threat to the capital reserve. In 2014, ICBC warned that; "the rate smoothing framework would be in a mode of using capital every year and not being able to re-build what has been used to smooth rates.

[7] BCUC, ICBC 2014 RRA, IR1, RM 2.
[8] BCUC, ICBC 2016 RRA, Procedural Conference Vol. I, 28 October 2016, p. 14.

This is clearly unsustainable and such a situation would ultimately end in capital falling below its regulatory minimum."[9]

The rate of increase in Basic costs (driven by BI claims costs) in recent years has been greater than the increase in the capped revenue. From 2012 to 2015, the government transferred $936 million of Optional capital to the Basic program to maintain an adequate capital reserve. In the 12 months of 2016 another $373 million transfer of Optional funding has been approved by cabinet to keep Basic rates suppressed. Table I shows that from 2012 to 2015 the cumulative indicated revenue requirement (130.8%) exceeded the request (116.8%) by 14%.

TABLE I RATE CHANGES AND CAPITAL RATIO (percent)

	PY2012	PY2013	PY2014	PY2015	PY2016
Indicated Rate	11.2	11.8	5.2	11.2	15.5
To Capital	nil	6.6	nil	5.7	10.7
Requested Rate	11.2	5.2	5.2	5.5	4.9
Approved Rate	11.2	5.2	5.2	5.5	4.9
Capital Ratio	137	149	137	118	100

Source: ICBC rate requirement applications; capital ratio is fiscal year-end from annual reports adjusted to incorporate capital transfers of $486 million for 2012 and 2013, $450 million for 2015 and $373 million for 2016. The capital ratios for 2016 are for 12 months to 31 December 2016.

For the five years, the total funding transferred from the highly profitable Optional program, including $373 million for the 12 months of 2016, totals approximately $1.3 billion. This is significantly more than the increase in revenue received from the cumulative 36% rate increase (and the growth in policies) for the period.

Depleting Assets to Subsidize Operational Costs

The government has been suppressing policyholders' Basic rates and funded the resulting operating deficits by depleting ICBC's Basic and Optional capital reserves. In effect, this is the equivalent of reducing savings to fund an unaffordable life style. It is unsustainable and a recipe for what the financial community calls a "hard landing."

Unlike BC Hydro, where the government has been suppressing domestic electricity rates by increasing debt,[10] ICBC cannot use deferral accounts and debt financing to continue to finance losses resulting from controlled prices. The reduction in the policyholders' capital reserve cannot continue as the reserves will be at the regulatory minimums by 31 March 2017.

[9] BCUC, ICBC 2013 RRA, Final Arguments, p. 24.
[10] See Richard C. McCandless, "Rate Suppression and Debt Transformation: The Political Use of BC Hydro, 2008 to 2014." *BC Studies*, No. 191, Autumn 2016,

Hope for Reduction in Claims Costs?

The 2016 rate request supporting data and graphs do not provide any hope that claims costs will moderate in the mid-term. In fact, ICBC states that in 2017 it expects the BI severity trend will return to a ‘normal’ higher level. Appendix II, tables 1 and 2 show that recent BI claims and costs have been increasing at a faster rate than the rate recorded during the 2011-2013 period.

It is also worthy of note that ICBC is now discussing an apparent growing social propensity to file claims for pain and suffering.

3. FALSE DISTINCTION BETWEEN BASIC AND OPTIONAL POLICYHOLDERS

The current regulatory model creates an artificial separation between Basic and Optional policyholders. Vehicle owners are compelled to purchase their minimum liability coverage from ICBC, but because the extended coverage is considered as a personal preference, the government believes there is no perceived public interest for an independent body to regulate Optional rates. The free market would determine the correct price. Given the low 3rd party Basic limits, any responsible vehicle owner views the additional coverage as necessary, and some 90% of Basic policyholders also purchase the additional coverage. About 80% to 82% of Basic policyholders purchase the ICBC’s Optional product (ICBC does not publish this information),[11] giving ICBC 90% of the Optional market in BC.

The reality is that vehicle owners do not have two bank accounts to pay for their Basic and Optional insurance, it all comes from a single source. The government-directed subsidy of Basic policyholders’ rates comes at the expense of those same policyholders who pay higher Optional rates, only to see their accumulated capital decline. The government, when announcing annual Basic and Optional rate increases, acknowledges the “single wallet” by focusing on the combined financial impact to the policyholder.

4. THE CAPITAL RESERVE

Capital Reserve Decline

An adequate capital reserve to pay claims is vital to all well managed pension and insurance companies. Most Canadian property and casualty insurers must adhere to risk-weighted capital reserve adequacy targets established by the federal Office of the Superintendent of Financial Institutions (OSFI). The OSFI minimum capital test (MCT) supervisory level of 150% (weighted assets divided by weighted liabilities) for insurers in a competitive market was modified to 100%

[11] In 2013, ICBC stated that about 80% of Basic policyholders purchase ICBC’s Optional coverage; http://www.huffingtonpost.ca/2013/08/30/icbc-insurance-rate-increase_n_3846092.html

and adopted by the BC government for the compulsory Basic insurance.[12] The Optional insurance minimum MCT was set at 200%, although the ICBC board of directors later raised the management target to 260%.

The BCUC, on the recommendation of ICBC, initially set the capital management target at 130% to provide a margin for adverse events, and raised the target in 2013 to 145% as a further buffer against the potential risk to the capital reserve resulting from the price control scheme.[13]

While the government did not impose price controls until 2013, it began to direct the use of the Basic capital three years earlier. In 2010, with the actual reserve well above the management target, the government ordered the BCUC to suspend of any capital rebate. In 2011, it ordered that the capital be used to moderate rate increases, and ordered the suspension of any capital build for three years.[14]

While the rapid increase in claims costs has been the main driver of the decline in the capital reserve, the extended period of low interest rates has also had a negative impact. Lower interest rates reduced the investment income received from fixed income (mostly bonds) investments, and reduces the discount rate on the value of pending and future claims. A short-term decline in interest rates will provide some off-set by increasing the fair market value of the higher yielding bonds, but as the low rates persist this effect is dissipated as the bonds mature and are replaced by new, lower-yield bonds. The change in fair value of the assets directly affects the capital reserve level.

The combined effect of the change in investment income and the fair value of assets (including pension adjustments) for Basic insurance is displayed in Table II. This display provides a five-year summary of the effects of the marginal combined change in investment income, and the fair value of assets included in Other Components of Equity.

TABLE II INVESTMENT INCOME AND ASSET VALUE ($=millions)

	2012	2013	2014	2015	F2016
Investment Income	281	437	559	608	252
Oth. Comp. of Equity	233	172	(171)	(329)	(273)
Combined	514	609	388	279	(21)

Source: ICBC annual reports; 2016 is ICBC's forecast for 12 months of 2016 from BCUC, ICBC 2016 RRA, IR 1, RM 1.

All insurance and pension funds are negatively affected by the continuing low interest rates. ICBC is unique, however, in that it must follow the direction of government to suppress the

[12] Annual rates must be set to ensure that the capital did not fall below the 100% minimum level.
[13] An expanded discussion of MCT adequacy can be found in Chapter 2 of http://www.bcuc.com/Documents/Arguments/2015/DOC_43293_03-12-2015_McCandless_Final-Argument.pdf

[14] See Appendix II for a summary of the key directives to ICBC and the BCUC.

true cost of Basic insurance by allowing the capital reserve to decline to the minimum regulatory level.

What Level of Reserve is Adequate?

From 2008 to as recently as 2015, ICBC had assured the BCUC that a large capital reserve was required to protect claimants from adverse events. With the advent of price controls, ICBC cautioned that if future price increases failed to match the rise in costs the Basic reserve would fall below the minimum requirement.

Perhaps the actuaries and forecasters at ICBC could foresee that, with the growth in claims costs, the price control limitation was too low. As late as February 2016 ICBC was attempting to convince the BCUC that a capital management target greater than 145% was necessary to protect claimants from potential adverse events.[15] ICBC advocacy of a high capital target seemed at odds with the government policy to deplete ICBC's capital to suppress Basic rates.

By the PY2016 rate submission ICBC management seemed to have conformed to the government's direction to place a lower priority on the financial health of the Basic program, as compared to the perceived short-term advantage of shielding policyholders from the true cost of Basic insurance. As Dylan wrote: "May you have a strong foundation, when the winds of changes shift."

The winds had shifted. Rather than rebuilt the capital, which was prevented by an earlier cabinet order, the government now restricted the 2016 amount of funding available to maintain the existing capital ratio (by increasing assets in proportion to increasing liabilities). In response to a question as to whether a capital reserve ratio of 100% was now sufficient, ICBC did not mention its' earlier concern regarding the risk to claimants of operating with a capital ratio of less than 145%.[16]

5. OBSERVATIONS ON THE 2016 REQUEST

Growth in Liabilities Puts Pressure on Indicated Rates

The estimated cost of settling pending and future claims is shown on ICBC's balance sheet as a liability. Under the OSFI risk weighting formula the value of the unpaid claims liability is inflated by approximately 5%, which means that there must be $1.05 in risk-free assets available for each dollar of claim liability to achieve a MCT ratio of 100%.

[15] See BCUC, ICBC 2015 RRA, ICBC Final Arguments, March 8. 2016. P. 45.

[16] BCUC, ICBC 2016 RRA, IR 1, RM 2.1 The revised regulation requires the BCUC to set rates on the assumption that the 145% target is in place; in other words, the BCUC cannot lower the target. The writer had previously urged the BCUC to lower the management target on the assumption that the trend in claims costs would moderate. The 2016 cabinet change to SD IC2 eliminates this opportunity.

In the four years from FY2011 to FY2015, the Basic unpaid claims liability climbed from $4.82 billion to $6.95 billion. The increase of some $2.13 billion required approximately $110 million more of risk-free assets to maintain the 100% ratio.

The OSFI risk formula encourages insurance companies to manage their unpaid claims backlog to keep the MCT ratio from declining. In recent revenue applications ICBC has stated that the benefits from new business processes and IT systems would compensate for any claims processing delay caused the reduction in claims adjudication staff.

For the current year, however, ICBC appears to have recognized that the claims processing capacity was inadequate, and announced the addition of new claims staff to moderate the growth in the value of the unpaid claims liability.[17] ICBC is to be complemented in finally acknowledging the direct link between the value of the claims liability and the MCT ratio. ICBC may be optimistic in assuming the larger claims processing capacity will have a significant dampening effect on costs or the BI severity trend for FY2016/17.

The Indicated Requirement May Be Low

As a rule, the Commission should accept the claims costs forecasts developed by the ICBC team. The key assumptions, however, should be reviewed for reasonableness.

In the PY2016 forecast ICBC has made certain "prospective adjustments" that have a significant outcome on the indicated rate. Despite acknowledging that the long-term growth trend for BI average costs (severity) is 4.2%, ICBC based the forecast on a much lower increase.[18] This is a key factor because BI claims make up 75% of the total claims costs. As the PY2016 impact of the PY2015 shortfall combined with the PY2016 growth in claims costs represents about 10.2% of the indicated 15.5%, an underestimation of the costs of BI severity will have a serious impact on actual results.

ICBC justifies the lower severity factor by assuming the planned enhancements to claims processing capacity, and other initiatives, will lower the average cost of BI claims. This assumption may be correct, but to incorporate a major decline in the severity trend in both the prior year variance and the current year forecast raises the risk that the 15.5% indicated rate requirement is too optimistic. This concern is reinforced by noting that the 2015 average cost of BI pending claims was 5.4% higher than 2014.[19]

This example highlights the difficulty in relying on an annual rate review process that compares a forecast, based on past results plus prospective (or aspirational) adjustments, to the prior years' forecast (adjusted with the latest forecast). A second perspective, one grounded on audited financial results, is also required to provide a more complete view.

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[17] Although no new resources had been committed to fund the promised new hires.
[18] The loss cost forecast variance has also been adjusted to reflect a lower BI severity.
[19] See Appendix II, Table 2.

Given that forecasting the number and the ultimate cost of claims can be difficult – and ICBC has the scars from 2014 and 2015 to prove it – one would expect the rate forecast to be conservative, or to error on the side of caution. Instead, ICBC has produced a request that heavily relies on unproven favourable developments to set a net rate increase below 5%. As the complete 2016 rate request lowers the capital reserve to the regulatory minimum, the low claims costs forecast is highly risky.

More Downward Pressure on the Basic Capital Reserve

From 2012 to 2015 there was no need to consider any capital release because the actual Basic capital had fallen well below the BCUC management target, and only maintained above the regulatory minimum by large capital transfers from the Optional program. In these years ICBC continued to include a capital maintenance provision in the annual rate request to account for the increase in liabilities.

Until this year the BCUC had the authority to adjust the Basic capital management target, while the ICBC board of directors determined the Optional capital management target (currently 260%). During the 2016 legislative session, the government amended the Insurance Corporation Act to allow the cabinet to set the capital management targets. The opposition called this another step in the politicization of ICBC. Finance minister Michael de Jong would only concede that the change gave the cabinet more the opportunity to "utilize the proceeds of the optional side of the business to reduce the pressure that would otherwise accrue on ratepayers on the basic side of the business. There is, it strikes me, a fairly apparent benefit that could accrue from the use of this particular instrument."[20] Cabinet now had the authority to ignore ICBC's actuaries.

In August 2016 cabinet deleted from Special Direction IC2 the previous requirement that BCUC approve the Basic capital targets.[21] This change further reduced the remaining discretion of the Commission to alter in any meaningful way the government approved rate for 2016. The rate submission also limited the capital maintenance provision, which will cause the actual MCT to fall as the growth in liabilities exceeds the growth in assets.

Mitigation Strategies Not Discussed

ICBC developed the rate submission within the context of the government's policy and directions. There are other cost reduction or revenue increase options that would lessen or eliminate the structural deficit in the Basic program.

Legislative change to cap awards for minor pain and suffering claims would likely produce significant ongoing BI claims costs savings of at least $100 to $150 million. The government could reimburse ICBC for the administration cost of issuing drivers licences, vehicle registration and the collection of provincial fines, as the government collects fees and fines while Basic

[20] BC Government, *Hansard*, 9 March 2016, p. 11263.
[21] OIC 615/16. The BCUC cannot lower the capital management target to reduce the need for new funding for capital maintenance.

policyholders are burdened with the cost.[22] The ongoing additional revenue could amount to at least $100 million. The province requires ICBC to provide a 25% senior discount on Basic rates. It should reimburse ICBC for the foregone revenue (paid by other policyholders) which could add a further $100 million to revenue from the province.

While the government has increased the financial sanctions for distracted driving, it has not given a high priority to reducing vehicle crashes by funding more public education, or more severe traffic enforcement measures. In fact, the government continues to resist re-instating photo radar to reduce speeding.[23]

The government could direct ICBC to institute a system for online policy renewals to reduce broker commissions. Rebalancing the vehicle risk weightings and the safe driver discount system would also produce longer-term savings.

These cost reduction and revenue increase measures would help return the Basic program to a satisfactory financial condition.

6. IMPLICATIONS FOR FUTURE RATES

ICBC assures the BCUC that the 4.9% requested rate increase is reasonable and just. This is correct if the Commission is only concerned with the FY2016/17 capital ratio. But what are the implications for ICBC's policyholders for 2017 and beyond? Since ICBC is not forecasting a reduction in the claims costs trend, one must assume that the structural deficit will continue. In such a situation, a major 2017 increase in Basic rates can only be avoided if there is sufficient Optional capital available to continue the subsidy.

What of 2017/18?

Previous rate reviews have been myopic, focusing almost entirely on the reasonableness of the method to calculate the rate for the subject policy year. The rate request has been developed from claims frequency and severity models that use recent actual data, modified with aspirational adjustments, to produce the single year rate requirement forecast. Unfortunately, the BCUC has not required ICBC to extend the projections, for policy years and fiscal years, to provide a view as to future financial impacts.

In recent years ICBC resisted this writer's requests to produce multi-year forecasts of the implications of the proposed rate change on future net income and capital reserve levels. ICBC does prepare such forecasts for inclusion in the governments three-year fiscal plan and quarterly revisions. "Future year's net income projections," it states, "are not the subject of this revenue requirements proceeding."[24]

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[22] In 1998 the Supreme Court of Canada ruled that fee revenue must equate to actual administrative costs, otherwise the fee was a tax. The province still maintains a fee.

[23] See http://vancouversun.com/news/politics/b-c-unmoved-by-ontarios-return-to-photo-radar

[24] BCUC, ICBC 2016 RRA, IR 1, RM 1.8.

This year the BCUC realized that rendering a decision/opinion on the suppressed rate request does have significant implications for the Basic operating deficit and ICBC's corporate reserve position for both 2016/17 and future years. To gain some insight as to the implications the BCUC requested a multi-year forecast of Basic revenues, expenditures and the capital reserve. Unfortunately, ICBC filed its response confidentially, because the forecast could "prejudice ICBC…and its Basic insurance policyholders…."[25] ICBC is saying that policyholders must be shielded from knowing the future year impacts of the price control scheme.

In response to my request (IR 1 RM 1), ICBC did provide forecasts for year-end 2016, and for the 15 month 2016/17 fiscal period. Because the government changed the fiscal year, attempting to forecast on an April to March cycle is hampered by the lack of previous comparative financial reports. Table 1 is my forecast for 2017, which must approximate the 2017/18 fiscal year (including all the caveats that that implies).

TABLE III -- BASIC 2017 (12 months) FORECAST ($=millions)

	ACT 2014	**ACT 2015**	**ICBC 2016**	**RM 2017**
Rate Increase %	5.2	5.5	4.9	5.0
Total Revenue	2,508	2,713	2,941	3,180
Claims Current Year	2,298	2,620	2,867	3,100
Claims-Prior Years	97	238	115	115
Other Costs	463	597	465	475
Invest. Income	559	608	252	270
Non-Insurance	121	123	129	135
NET INCOME	87	(257)	(383)	(375)
Equity Prior	1,716	1,633	1,071	464
Retained Earnings	87	(257)	(383)	(375)
OCE & Other	(171)	(305)	(224)	(109)
Equity End	1,633	1,071	464	(20)
MCT %	136	84	33	(1)
Optional Transfer 2015	nil	450	450	450
Optional Transfer 2016	nil	nil	472	472
Equity Adjusted	N/A	1,521	1,386	902
MCT % Adjusted	N/A	118	100	64

Notes: 2014 and 2015 are actuals as per ICBC annual reports, 2016 is from IR 1 RM 1, and 2016 assumes a 5% rate increase, 1.7% sales increase and a (0.4) % decline in the average

[25] "Given the uncertainty in the long-term view of key assumptions, including loss cost trends and associated impacts on those trends from current and future mitigating strategies, any long-term forecast would be considered highly speculative. For this reason, the content removed is considered confidential since there is a concern that the information could be taken out of context and used to prejudice ICBC and its Basic insurance policyholders and thereby harm ICBC's financial interest." See BCUC, ICBC 2016 RRA, IR 1, BCUC 19.1.

premium. Current year claims for 2017 rise by 8%. Assumes some increase in asset value (OCE) compared to 2017.

While the 4.9% rate increase would allow a 6.4% increase of 2017, this scenario uses a 5% increase. A simplistic as this forecast is,[26] it is instructive. Assuming no further infusions of Optional funding the MCT ratio would fall to 64% by 31 December 2016. To achieve a 100% ratio would require approximately $500 million. Increasing the MCT target ratio to 110% would increase the shortfall by approximately $140 million.[27]

To generate $500 million by 31 December 2017 (by extension 31 March 2018) would require a massive rate increase in November 2017. However, if the shortfall was made up with a 12-month lead time (a 1 April 2017 rate adjustment) the increase could be approximately 20%.

DECEMBER 20TH INSERT

On November 23, 2016, ICBC publicly filed the PY2017 to PY2020 Basic financial forecast. The projected growth in rates touched off a short but intense public and media concern.[28] By filing a policy year forecast ICBC avoided discussing the requirement that the Basic capital ratio remain above the 100% regulatory minimum by year-end 2017/18. This is explained in my commentary published in the Times Colonist on 23 November 2016, and occasional paper number 16.[29]

The forecast did not provide any hope that the growth in claims costs would decline in the next few years. In fact, the growth in claims costs rises each year from PY2016 to PY2019.

The four-year rate plan assumed that rate suppression would continue, and that the resulting deficit in the Basic capital would be covered by a transfer of $1.5 billion from other sources. ICBC declined to name the source of the $1.5 billion addition to the Basic capital.[30]

The Optional "Bank"

Historically, the high profits generated by the Optional program have allowed the accumulation of a large capital reserve. In 2010, the government amended the governing legislation to appropriate "excess" Optional policyholders' capital.[31] In 2015, minister responsible Stone,

[26] No separation between Optional net income and capital is shown for 2016, as it all eventually impacts the capital reserve ratio.
[27] Assuming $14.2 million equals 1% MCT. The ICBC forecast for 2016 used $13.9 million.
[28] See http://www.bcuc.com/Documents/Proceedings/2016/DOC_48181_B-6_ICBC-Response-to-Ex-A-9.pdf and http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_17_26_nov_2016/pdf

[29] http://www.timescolonist.com/opinion/op-ed/comment-be-prepared-for-icbc-rate-increase-shock-1.3101218 and http://www.bcpolicyperspectives.com/blog/posts/icbc-rates-capital
[30] BCUC, ICBC 2016 RRA, IR 2, RM 1.
[31] From 2010 to 2015, close to $1.2 billion was appropriated. Excess in 2015 was the amount over a 260% capital management target.

defending the 260% Optional capital target, said it was necessary to protect claimants against adverse events and in line with the industry standard.[32] But the $450 million transferred to subsidize the 2015 Basic rates lowered the Optional capital ratio approximately 232% to begin FY2016/17.[33]

With the continued deterioration of Basic finances, the government apparently decided that the 260% capital management target ratio was too high, and changed the Insurance Corporation Act in the spring legislative session to allow the cabinet (rather than ICBC's actuary) to set the management target. This clears the way for a reduction in the target to reflect a further capital decline caused by the $472 million current year transfer necessary to keep the Basic capital ratio at the regulatory minimum.

The financial condition of the Optional program is now vital to continuing the Basic rate suppression beyond PY2016. In the absence of ICBC releasing any Optional financial forecasts, it is necessary to develop a forecast for the 12-months for 2016 and 2017. Table 2 is a scenario which again assumes the calendar years, which align to previous fiscal years, provide a reasonable approximation to the 2016/17 and 2017/18 fiscal years.

TABLE IV – OPTIONAL 2017 (12 months) FORECAST ($=millions)

	ACT 2014	**ACT 2015**	**RM 2016**	**RM 2017**
Rate Increase %	nil	2.2	2.8	3.0
Total Revenue	1,739	1,829	1,957	2,105
Claims Current Year	1,081	1,178	1,250	1,345
Claims-Prior Years	84	6	10	10
Other Costs	582	569	575	580
Invest. Income	293	312	200	200
NET INCOME	285	387	322	370
Equity Prior	1,757	1,983	1,625	1,355
Retained Earnings	285	387	322	370
OCE & Other	80	(157)	(120)	(80)
Equity End	2,122	2,213	1,827	1,645
MCT %	317	321	250	216
Capital to Province	139	138	nil	nil
Basic Transfer 2015	nil	450	incl.	incl.
Basic Transfer 2016	nil	nil	373	incl.
Equity Adjusted	1,983	1,625	1,454	1,645
MCT % Adjusted	297	236	202	216

[32] BC Government, *Hansard*, 23 April 2015.
[33] Excluding the complications of financing the Transformation Program.

Notes: 1. 2014 and 2015 are actuals as per ICBC annual reports; although 2015 was adjusted to reflect the retroactive transfer to Basic. Calendar years 2016 and 2017 are my estimates assuming 7.6% increase in total revenue, 7.6% increase in current year claims.

2. The Optional 2016 capital ($172 million) and operating ($201 million) transfers have been consolidated in the "Basic Transfer 2016" as $373 million, with a further $99 million in net income to follow as a retroactive adjustment. The 2017 "Equity Prior" of $1.355 billion incorporates the $99 million retroactive adjustment. The 2016 MCT calculations assume 1% equates to $7.2 million, and $7.6 million for 2017.

3. The assumed FY2017/18 combined Basic and Optional net income is a deficit of $5 million; and the combined net income on the government's September 2016 forecast for ICBC for FY2017/18 is a deficit of $3 million.

Based on this relatively simplistic forecast, it seems that the 2016/17 transfers to Basic were calculated to allow the Optional year-end MCT to remain above the regulatory minimum. The scenario suggests that the 2017/18 capital ratio would recover to 216%.

The Bitter End of Rate Suppression

If the government is considering another Optional transfer in 2017/18 to mitigate the indicated Basic rate increase, there is little room left for maneuver. Lowering the Optional capital reserve to 200% could produce approximately $120 million in funding to reduce the indicated $500 million Basic shortfall.[34]

A higher risk option is to lower the Optional capital regulatory minimum to 150%, which would free approximately $380 million more to subsidize the indicated 2017 Basic rate requirement. This reduction in the minimum Optional capital target would contradict the long-standing requirement that the Optional capital ratio should be no less than 200%, and it would likely meet opposition from private insurers who would accuse the government of keeping 2017 Optional rates abnormally low. Conversely, choosing a significant increase in Optional rates to produce more net income to subsidize Basic rates risks a loss of sales.

Summary for 2017/18 and 2018/19

The 4.9% increase in Basic rates, even with a $472 million infusion of Optional funds, will result in the Basic capital ratio falling to the regulatory minimum by 31 March 2017. With a 5% rate increase for 2017, and no Optional transfers, the Basic capital ratio will decline to approximately 65% by 31 March 2018. Approximately $500 million would be required to achieve the minimum 100% capital ratio. and $640 to achieve a ratio of 110%.

If the government directs another Optional transfer for 2017/18, only some $120 million would be available before the capital ratio drops to the regulatory minimum. By lowering the regulatory minimum to 150% a further $380 may be available to continue the Basic rate subsidy. If the

[34] Based on 25 basis points at $7.6 million/1% MCT.

government drops the Optional regulatory target a simplistic projection to 2018/19 would suggest that the Optional piggy bank would be empty, with the capital near 150%. By 2018 the music will have stopped. The government policy of draining ICBC's assets to suppress Basic rates would end, leaving policyholders with the prospect of a massive rate increase, and claimants with a higher risk of having their claims paid.

On must question not only the financial prudency of such a result, but also the impact on intergenerational equity. Clearly, there are various ways to determine whether the 2016 rate request is fair and just.

7. RECOMMENDATIONS

DECEMBER 20TH INSERT

The government decision to order the Commission to approve the 4.9% increase by 16 January 2017 would seem to preclude a further rate increase as suggested below. The other recommendations should be incorporated in the Commission's decision.

Given the information provided, an ongoing structural deficit exists in the Basic program. The government's nihilistic price control policy will reduce the value of Basic and Optional capital reserves to the regulatory minimums by 31 March 2017. In the absence of some clear indication that lower future claims costs, or a major increase in interest rates, will eliminate the deficit, it seems clear that the purpose of the rate suppression policy is political expediency. By shielding policyholders from paying the true cost of auto insurance, the government hopes they remain contented, at least until after May, 2017.

Through restrictive directives, the government has reduced the authority of the BCUC to the point where it cannot alter the 4.9% rate request in any meaningful way. However, the Commission can and should highlight the longer-term consequences of the unstainable price control policy, and prepare ICBC policyholders for the inevitable cost increases, or coverage reductions, that lurk in the immediate future.

The year-end capital ratio is the key determinant, therefore the earlier in a fiscal period that any cost containment and/or revenue increase measures take effect the greater the benefit in reducing the size of a future rate increase.

The Commission should also review the current funding model with a view to rationalizing the current imbalance where policyholders are incurring costs when the government is receiving the financial benefits.

Approvals

Approve the 4.9% rate increase, but approve an additional 2.1% increase effective within two months of the BCUC decision; rates for new or renewal policies will increase by 7% on that date, and the base rate for PY2017 will be 7%. The rate increase would have no impact on the 2016/17 year-end capital ratio, but would lessen the rate shock for PY2017.

Provide a forecast of what increase Basic policyholders are likely to face for PY2017 assuming no Optional funds transfer, and no price controls. This will provide policyholders with more and earlier information about likely rate increases for PY 2017, to allow households to plan for the additional cost.

Advice to Government

Recommend that the government to rescind the price control directive, and restore to the Commission the authority to set the capital management target. The price control scheme has proved a failure as it has created a structural deficit and seriously weakened the capital reserve. The government should adopt the recommendations of the 2014 independent Task Force, and allow the BCUC to set rates based on the cost of service.

Recommend that the government make traffic safety a priority, and devote a significant portion (say 10%) of revenue received from traffic/moving fine revenue to improving enforcement and public education.

Recommend that the government reimburse ICBC for the costs of enhanced policing, the administration of the drivers licence program, the collection of provincial fines and other non-insurance costs currently paid by Basic policyholders. Given the severe imbalance between Basic costs and revenues, the government should reimburse ICBC for its administrative costs where the government receives fee or fine revenue or enhanced services. Currently, policyholders are subsidizing the government.

Recommend that the government expand the regulatory authority of the Commission to include the Optional program. Basic policyholders are Optional policyholders. The financial health of the Optional program is vital to the health of the Basic program.

Recommend that the government reimburse ICBC for the foregone revenue because of the seniors' discount. This government policy results in those over 65 receiving a subsidy of between $85 and $100 million from other vehicle owners. If the government reimbursed ICBC for this subsidy it would amount to an ongoing savings for the balance of policyholders to help offset rising costs.

Requirements for ICBC

Require ICBC to file a plan by 1 July 2017, including the costs and benefits, which would impose a cap on minor pain and suffering awards modeled on the Alberta system, expanded to include dental claims. Such a cap could reduce claims costs by perhaps +/- $200 million annually.

Require ICBC to provide a more definitive analysis of the causes of the growth in BI and PD claim frequency and severity during the last five years.

Require ICBC to provide a cost benefit analysis and timeline for policyholders to renew online, including payment by credit card for renewals of less than 12 months.

Require ICBC to file a full DCAT solvency analysis with the PY2017 rate request.

Process Changes

Require ICBC to file a three-year fiscal and capital impact forecast with future rate requests.

Require ICBC to post quarterly financial reports, including the capital ratio, for the Basic program on its public web site.

Require ICBC to file, by 1 June 2017, a discussion paper on whether the policy year should align more closely with the new fiscal year. The government changed the fiscal year to align with the government fiscal year. Are there benefits in aligning the policy year more closely with the fiscal year as well

APPENDIX I -- KEY GOVERNMENT DIRECTIVES RESPECTING BASIC INSURANCE

2005
OIC 734/05 Letter of October 5, 2005 to ICBC directing the transfer of $ 530 million to Basic capital to achieve 100% MCT by FY2005 to enable maintenance of low and stable rates.

OIC 735/05 October 5, 2005 Commission must accept government directives to ICBC

2007
OIC 39/07 Letter of January 31, 2007 to ICBC regarding proposed rate design.

OIC 38/07 Letter of January 24, 2007 to ICBC directing transfer of $ 100 million to Basic capital for FY2006 to complete the balancing of ICBC's capital and achieve 100% MCT.

2010
OIC 222/10 Letter of April 19, 2010 to ICBC; fund the Transformation Program ($ 400 million) from Optional capital.

OIC 287/10 Letter of May 18, 2010 to ICBC; suspends any rebate under the capital management plan to avoid possible rate volatility due to uncertain investment markets and thereby enhance the effectiveness of the capital management plan.

2011
OIC 560/11 Letter of November 25, 2011 to ICBC; moderates the direction of May, 2010, as ICBC should use more Basic capital in the short term:" The government believes that the capital available above the Basic insurance regulatory minimum should be made available to help manage rates." (p. 2) Capital build excluded from the rate request for the next three policy years.

2012
OIC 82/13 Letter of December 13, 2012 to ICBC; transfer all Optional excess capital to Basic for FY2012 to allow MCT to be equal to or above the 100% MCT level.

2013
OIC 152/13 March 2013; amendments to SD IC2; incorporating rate smoothing, a customer renewal credit and annual rate changes; annual rate increases are limited and rates cannot decrease; the Commission to set rates to allow Basic to maintain at least 100% MCT level.

OIC 153/13 March; ICBC directed to seek BCUC approval for a revised capital management plan "to use Basic capital to promote more stable and predictable Basic rates." If the MCT reserve ratio is projected to fall below 100% ICBC must, in conjunction with Treasury Board, develop a plan to restore the capita level.

2014

OIC 15/14 February; transfers balance of excess Optional capital to Basic for 2013 ($113 million).

OIC 56/14 February; changes policy year to November 1st.

2015

OIC 597/15; directs that $450 million of Optional capital be transferred to re-inflate the Basic capital reserve.

2016

Bill 10; Insurance Corporation Act amended to allow ICBC capital reserve targets to be set by cabinet order; changed the fiscal year to April to March.

OIC 614/16 August; orders Optional transfer of $300 million of net income and $172 million of capital to allow ICBC to propose a 4.9% rate increase despite a forecast requirement of 15.5%.

OIC 615/16 August; amends Special Direction IC2 deleting all references to Commission approval of the Basic capital reserve target. BCUC must set rates for next three years assuming capital management target of 145%.

OIC 960/16 December; orders the Utilities Commission to approve Basic 2016 rate increase of no more than 4.9% by 16 January 2017.

APPENDIX II – CLAIMS AND CLAIMS PROCESSING

The following summaries have been developed from the information provided by ICBC in response to IR1, RM 4.1. A negative percent change indicates a decline in the number and cost of claims, which has a positive impact on claims costs. Conversely, a positive change has a negative impact on claims costs. The Trend compares the 2011 to 2013 (two year) period with the 2013 to 2015 (two year) period.

Clearly the 2014 and 2015 increase in new claims and the average cost per claim has weakened ICBC's forecasting models, which tend to use a longer historic horizon to forecast future frequency and severity targets.

TABLE 1 – BASIC BODILY INJURY (Percent Change)

	2011-2013	2014	2015	2013-2015	TREND
New Claims	3.5	4.3	12.0	16.8	**negative**
Closed Claims	8.3	1.5	2.4	3.9	**negative**
Pending Claims	11.4	4.4	10.2	15.0	**negative**

Compared to the 2011 to 2013 period, the last two years showed a rapid growth in new claims (especially 2015), and a significant slowing in closed claims. The percentage growth in pending claims has out-paced the already high increase recorded in the 2011 to 2013 period.

TABLE 2 – COST PER BODILY INJURY CLAIM (Percent Change)

	2011-2013	2014	2015	2013-2015	TREND
Average Cost/ Claim					
Closed Claims	(9.2)	13.3	4.0	17.9	**negative**
Pending Claims	(6.2)	6.6	5.8	12.8	**negative**

Table 2 shows the percentage change in the average cost per claim. For the 2011 to 2013 period to cost was declining, both for closed and pending claims. The 2014 to 2015 trend turned negative, and 2014 was a particularly poor year.

The rise in the average BI claim cost, combined with the recent growth in claims, has compounded the impact on the Basic BI claims costs, and the claims backlog.

TABLE 3 – BASIC PROPERTY DAMAGE (Percent Change)

	2011-2013	2014	2015	2013-2015	TREND
New Claims	nil	22.7	4.5	28.3	**negative**
Closed Claims	2.0	(19.4)	44.8	16.8	**negative**

Pending Claims	(18.2)	400.0	27.6	410.0	**negative**

Table 3 shows that while number of new PD claims in 2013 was about the same as 2011, new claims jumped by 22.7% in 2014. Data errors may explain the fluctuations in closed claims between 2014 and 2015, but the trend is clearly negative. The growth in pending PD claims has less impact on the unpaid claims backlog compared to the growth in BI claims, because the average cost of a BI claim is approximately $43,000 compared to $2,000 for a PD claim.

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