ICBC 2016 RRA FURTHER PROCESS SUBMISSION

On 16 January 2017, the Commission invited submissions on the scope and process for the remaining review of ICBC's 2016 RRA. It suggested that further examination of issues involving the affordability and sustainability of the compulsory Basic program would be addressed by the proposed "independent review" announced by the government on 19 December 2016.

I submit that the BC Utilities Commission, as the regulator of the Basic program, has a major interest in the recommendations of the proposed review, and should ensure that certain key products of the review are incorporated into the PY2017 rate request.

As the rate increase component of the PY2016 review has been effectively decided by cabinet fiat, the balance of the current review should be used by the Panel to formulate concerns regarding the affordability and sustainability of the finances of the Basic program, and to provide direction to ICBC concerning the scope and format of the PY2017 review.

THE CURRENT RATE-SUPPRESSED SYSTEM IS NOT SUSTAINABLE

The latest forecast shows that the current funding model for the Basic insurance program is unsustainable.

In 2013 the government required the Commission to depart from the cost of service model (COS) for rate-setting, and limited the rate increase allowed. This rate suppression policy has dampened the annual increase in Basic rates, but has been only possible by the infusion of $1.4 billion in Optional program operating and capital dollars from 2012 to 2016/17. Even with this subsidy, the Basic minimum capital test (MCT) capital reserve ratio has fallen to about the regulatory minimum, as shown in Table 1.

TABLE 1 EFFECT OF RATE SUPPRESSION ON RATES AND MCT RATIO (Percent)

	2013	2014	2015	2016	2017F	2018F	2019F	2020F
BC CPI	(0.1)	1.0	1.1	1.9	2.0	2.0	2.0	2.0
Indicated Δ	11.8	5.2	11.2	15.5	14.9	13.5	11.0	7.4
Requested Δ	5.2	5.2	5.5	4.9	6.4	7.9	9.4	7.9
MCT Ratio	149	137	118	102	76	50	27	10

Source: CPI from BC Government, Financial and Economic Review 2016, and Budget and Fiscal Plan 2016/17 to 2018/19. Forecasts from BCUC, ICBC RRA 2016, IR1, BCUC 19.1C, Table 2. The MCT are as of fiscal year-end.

The forecast for PY2017 to PY2020 are from the multi-year forecast reluctantly provided by ICBC on 23 November 2016. It shows that under the rate suppression regime the capital ratio drops to only 10% by 2020. In the same forecast ICBC stated that $1.5 billion in additional capital would be required from 2017 to 2020 to keep the reserve ratio at the regulatory 100% minimum for the four-year period.

Table 2 shows the effect of incorporating the $1.5 billion capital addition into the total Basic funding rate-suppressed revenue of $884 million. The cumulative equivalent rate increase is approximately 117% from 2017 to 2020.

TABLE 2 FUNDING AND EQUIVALENT RATE INCREASE ($=million)

	-------Rate Increase---		----Capital Addition---		--------Total---------	
	AMOUNT	**PERCENT**	**AMOUNT**	**PERCENT**	**AMOUNT**	**PERCENT**
2017	179	6.4	330	11.8	509	18.2
2018	221	7.9	405	14.5	626	22.4
2019	263	9.4	405	14.5	668	23.9
2020	221	7.9	365	13.0	586	20.9
TOTAL	884		1,505		2,389	
CUM.%		35.5		65.7		116.8

Source: BCUC, ICBC 2016 RRA, Exhibit 6, Table 1.

Notes: The forecast was based on the assumptions detailed in Exhibit 6, which makes no allowance for the ageing customer base, producing less premium revenue per policy due to the 25% senior discount.

As the Commission is aware, the release of the Basic forecast resulted in significant media comment and public concern.[1] Unfortunately, the media focused on the 42% cumulative rate increase from 2016 to 2020, and not the effect of the additional capital requirement.

If a 42% rate increase over five years caused such serious public concern, how would the public react to a 117% increase over four years?

The Commission should ensure that ICBC is given fair warning that a similar multi-year forecast must be incorporated into ICBC's PY2017 submission.

EFFECT OF 100% MCT REQUIREMENT BY YEAR-END

The forecast presented on 23 November 2016 are based on rate changes using a November to October policy year. The minimum MCT 100% ratio must be achieved by 31 March of each

[1] Including the *Vancouver Sun* urging the government to abandon the rate cap http://www.bcpolicyperspectives.com/blog/posts/icbc-politics

year. The effect of this little understood year-end requirement can result in the need for a much larger rate increase in November than would be required if the capital ratio test date was 31 October. This is further explained in my Occasional Paper No. 16.[2]

THE OPTIONAL BANK

The financial condition of the Optional program is now vital to continuing the Basic rate suppression beyond PY2016. But for how long can the government continue to subsidize Basic rates from Optional profits?

The major transfers to Basic in 2015 and 2016 have reduced the Optional year-end capital to near the regulatory 200% minimum. The Commission should require ICBC to provide a multi-year forecast of the Optional capital ratio in conjunction with the Basic financial forecast.

IS A 100% BASIC CAPITAL RATIO ADEQUATE?

In previous rate submissions ICBC argued that a capital reserve ratio of 150% was necessary, and the Commission has stated that 145% would be the management target. ICBC should be prepared to provide a solvency analysis using the CIA DCAT methodology.

FISCAL AND POLICY YEAR

The 23 November 2016 forecast demonstrated that both policy year and fiscal year comparisons are required to form a proper understanding of the implications of future rate requests. This should be required for the 2017 submission.

SEPARATE OPERATIONAL AND CAPITAL RATE APPROVALS

ICBC should provide an analysis on the advantages and disadvantages of the Commission approving separate rate increases for operations and capital. ICBC should report on actual performance compared to the assumptions in the PY2016 rate request.

OTHER ISSUES

On 20 December 2016 I submitted my final arguments in conjunction with my submission on the narrow issue of the 4.9% rate increase.[3] Beginning on page 17 of that submission I outlined several issues that the Commission should consider, including recommendations to the government, and directions to ICBC.

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2 http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_16_november_17_2016/pdf

3 http://www.bcpolicyperspectives.com/media/attachments/view/doc/bcuc_icbc_2016_final_20_dec_2016/pdf

To moderate the growth in expenditures ICBC should be prepared to discuss changes in coverage limits, including a cap on pain and suffering claims. The Commission should also review the current funding of non-insurance programs, since the financial benefit accrues to the government while Basic policyholders must fund the cost.

I would be pleased to elaborate on any of these recommendations.

The Commission can assume a passive posture and wait for the 2017 submission, much as it has done during the last number of years. However, I believe that given the rapid deterioration in the financial health of the Basic program, and in the financial condition of ICBC in general, the Commission must take a more active role. The public expects that the Commission to provide impartial oversight of the public auto insurer, and policyholders expect the Commission to represent and defend their longer-term interests.

A NOTE ON RATE INCREASES

The Commission would find a comparison of recent rate increases in the public compulsory auto insurance programs instructive. Table 1 shows that the cumulative five-year rate increase of ICBCs Basic program compared to the Saskatchewan Auto Fund (SAF) and the Manitoba Public Insurance’s Basic program.

Table 3 RATE CHANGES 2012 TO 2016 (percent)

	ICBC	SAF	MPI
2016	4.9	nil	nil
2015	5.5	nil	3.4
2014	5.2	4.4	0.9
2013	5.2	2.3	nil
2012	11.0	1.6	(8.0)
5 Year Cum. Δ	**29.7**	**8.5**	**(4.0)**

Source: Annual reports and rate requests.

Notes: Rates effective: ICBC November, SAF September and MPI March. On 15 December 2016 the PUB approved a 3.7% rate increase for the MPI for 2017/18, with a capital ratio of about 40%.

Clearly the no-fault programs in operation in Saskatchewan and Manitoba are not strictly comparable to the tort-based system in BC. However, the trend in the rate of increase (even with the rate-suppressed ICBC prices) forces questions as to what are the factors that result in such a wide discrepancy in the trends.

Richard McCandless January 24, 2017. http://www.bcpolicyperspectives.com/