OCCASIONAL PAPER 37 ICBC

A REVIEW OF THE ERNST YOUNG'S OPTIONS TO INCREASE AFFORDABILITY OF AUTO INSURANCE

"It will take some innovative thinking and painful choices to set things right." Times Colonist editorial respecting ICBC, August 3, 2017.

This report is a follow-up to my Occasional Paper No. 35,[1] which discussed the financial component of the Ernst Young report on ICBC, released on July 24, 2017. The purpose of this paper is to review the proposals to improve the affordability of the Basic insurance program.

The financial savings resulting from capping pain and suffering awards generally outlined in the report appear to be over-stated.

The new government could significantly reduce both injury claims costs, and auto insurance premiums, by adopting Saskatchewan's dual tort and no-fault compulsory insurance model.

BACKGROUND

Did the Liberal government deliberately plan and execute the financial crisis at ICBC, or was it a lack of foresight and political courage that led to the current financial crisis and large claims backlog of claims?

It is true that the Liberal government, desperate for new sources of cash during the recession that followed the 2008 financial crisis, began in 2010 to appropriate Optional policyholders' "excess" capital. From 2010 to 2015, approximately $1.2 billion was skimmed to help reduce the government's direct borrowing requirements; helping to burnish the government's image as prudent financial managers.

The alternative, of reducing the price of the lucrative Optional insurance even more than the cumulative 10% reduction over the six years, was not pursued.

Part of the explanation for not rewarding policyholders may be found in the need to husband more of the Optional capital to backstop the operating losses in the compulsory Basic program. Why was this massive subsidy of Basic policyholders by Optional policyholders (who are generally the same) necessary? Why has the balance of costs and

[1] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_36_29_july_2017/pdf

revenue in the not-for-profit compulsory Basic program become dangerously unbalanced?

Many factors led to the operating losses and the rapid decline in the Basic capital reserve (equity). These have been reviewed in earlier papers.[2] The main point is that the previous government was unwilling to commit the financial and political resources necessary to both reduce the number of crashes and the cost of the resultant claims.

Instead, it imposed a form of price control to moderate the rate of growth in Basic premiums. The previous government focusses on the policy goal of affordable rates and relative price stability and reduced the large Optional capital reserve to cover the resulting losses in the Basic capital. From 2012 to 2015, the government ordered ICBC to transfer $936 million of Optional capital to keep the Basic capital from falling well below the government's own regulatory minimum reserve level. For 2016/17, cabinet directed that a further $472 million of Optional funding be moved to offset most of the forecasted capital loss during the last extended fiscal year.[3]

From my perspective, the Liberal government was slow to react to the growth of Basic claims costs then, as the 2017 election loomed, it was unwilling to impose fundamental changes on the coverage model to reduce injury claims costs. The Liberal government gambled that it could keep the financial deterioration at ICBC from becoming an election issue.[4] Now the NDP government must quickly learn the intricacies of auto insurance financing and develop an integrated plan to moderate the growth of, or even reduce, Basic premiums.

CONFLICT OF OBJECTIVES

The Ernst Young (EY) report is a useful compilation of both the financial deterioration of ICBC, and the presentation of a series of options to reduce pressure on rates. The consultants were engaged to review the Basic program, but the options have spill-over impacts on the Optional program. A weakness of the report is its failure to make the distinction clear, which can lead to confusion on the part of a reader not familiar with the delivery structure and the related costing.[5]

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[2] See the ICBC section in http://www.bcpolicyperspectives.com/

[3] ICBC was required to convert to the government's April to March fiscal year from its January to December year; adding three additional months of Basic losses to the reporting period.

[4] In late November 2016 ICBC reluctantly complied with the BC Utilities Commission's order to file a five-year forecast for Basic rates. The forecasted increase in rates caused significant public concern. In late December, the government ordered the Commission to approve the 4.9% rate request, which essentially ended the review of ICBC's finances. During the election, the rising cost of auto insurance did become an issue as the NDP promised to freeze rates for one year while it undertook an operational review of ICBC. The Liberal party's costing of that promise generally confirmed the November rate forecast.

[5] This was evident in the financial information, see http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_36_29_july_2017/pdf

The objective of the report was to provide options for the government to increase the fairness and affordability of the Basic program, with affordability defined as future rate increases in line with inflation.[6] This pre-supposes that the current average Basic premium of approximately $875, and the average of $675 for Optional coverage, is reasonable. Is paying about 40% more than do drivers in Saskatchewan and Manitoba reasonable?

OPTIONS TO IMPROVE AFFORDABILITY

The EY report provides a range of possible changes or enhancements to improve the affordability of the Basic program (and the Optional program as well). These can be grouped as those focus on increasing revenue; those which should reduce the number of crashes (frequency) through enhanced traffic enforcement and driver education; and those that reduce the cost of claims (severity).

Revenue Enhancements

- Rebalance vehicle risk, which ICBC has failed to do for some years.
- Increase premiums for higher-risk drivers, which requires ICBC to shift from the current vehicle-based to a driver-based system.

EY did not propose that the provincial government reimburse policyholders for the costs of administering the issuing of driver's licenses (approximately $65 million), collecting provincial fines (refuse to issue), or the cost of the 25% discount for seniors (±$100 million).

Reduce Claims Frequency

- Expand use of intersection cameras
- Automated speed enforcement technology
- Expand use of police enforcement for impaired and distracted drivers
- Enhance public education and awareness

The EY report did not recommend that some of the resulting new fine revenue be directed to ICBC to fund the enhanced road safety initiatives. As the benefits of these road safety initiatives encompass more than just Basic insurance, Basic policyholders should not bear the full cost.

Reduce Coverage

The report correctly states that the growth in the number and cost of minor injury claims has been the primary reason for the rise in claims costs. The report proposes

[6] http://www.icbc.com/about-icbc/company-info/Documents/Affordable-and-Effective-AutoInsurance-Report.pdf, p. 2.

three options to reduce claim costs by capping the amount pain and suffering awards at various levels.

Other jurisdictions in Canada have legislated limits on pain and suffering awards; for example, Alberta's limit of approximately $5,000 for minor soft tissue injury claims has survived a series of court challenges. Ontario has a $30,000 deductible, effectively limiting pain and suffering claims to matters involving very severe injury.

The EY report links the limitation on claims for pain and suffering for minor claims (mostly soft tissue injuries) to a re-focus of ICBC's insurance model from the litigation based approach to one more focused on the care and rehabilitation of the accident victim. The is similar to the model proposed by David Marshall for Ontario, and echoes the recommendations of Doug Allen review in 1997.

Major claim costs savings are possible depending on the level of the cap. The report suggests that some of the savings be re-directed to enhancing the (Part 7) accident benefits which are available to injured parties regardless of fault. The government has not raised the monetary limits of these benefits since 1991, and the loss of purchasing power due to the rise in the cost of living has likely contributed to the increase in legal representation and increased litigation. Thus, short-term cost avoidance has promoted longer-term costs.

The EY report, while framing the coverage limitation as a shift to a comprehensive care model, does not elaborate of the cost or the administration of the agency which will coordinate the comprehensive care. Such a revision to the current insurance model would imply that the auto insurance model would move closer to the non-tort workers compensation model (Work Safe BC).

The focus on eliminating the Basic operating deficit ignores the potential consequential savings arising from the proposed frequency and severity options on the highly profitable Optional program. The EY options did not attempt to estimate the savings accruing to the Optional program, nor did it question the historically high profit margins. Readers would have benefited from a discussion as to why the Optional rates should not be reduced to assist Basic policyholders (who are the same individuals) afford higher Basic rates.

REDUCING COVERAGE -- DISCUSSION

The EY report provides three options to cap pain and suffering awards which produce three estimates of claims costs savings, as summarized on page 24. The fourth option, which has the greatest claims costs savings, is essentially the no-fault system in place in Saskatchewan, Manitoba and Quebec (Basic insurance only). Other possible changes are discussed in Appendix 1.

The report provides a baseline cost projection to 2019, and the estimated savings each option would achieve. The detailed assumptions for the baseline scenario and the savings are not provided, therefore it is not possible to verify the estimates.

However, for the little information provided, it appears that the $718 million cost of minor injury claims, and the $845 million in legal costs (page 23) are over-stated when compared to claims information for 2015 provided by ICBC. Appendix 1 provides more information on this critical point.

All the options propose a major enrichment to the current Part 7 benefits. This part of the package is weak, because doubling or tripling the wage loss benefit, for example, would put pressure on similar Work Safe BC (and other auto insurers) to match the increase. These consequences have not been explored by EY.

Fair Settlements

The report's recommended options are based on the premise that; "The goal of insurance is to restore premium payers to their pre-accident condition. Insurance is not designed to allow the insured to profit from loss as this would be unsustainable and unaffordable. Shifting the focus from cash settlements to claimants' treatment and care is an effective way to ensure they are returned to their pre-accident condition as best as possible and in a more cost-effective manner."[7]

The returning of victims (not policyholders) to their pre-accident condition, as described by EY, completely ignores the fact that claimants currently can claim for pain and suffering damages, which are designed to compensate for loss of enjoyment of life due to the injuries sustained in the crash, or "to place an injured plaintiff in the original position he or she would be, absent of the defendant's negligence."[8]

The plaintiff bar argues that eliminating or capping pain and suffering awards punishes all potential crash victims who will not receive compensation for the loss of enjoyment of life. It is only through the tort model that the victims' right to a fair and just settlement can be assured.

Conversely, it has been argued that if the cost of insurance becomes increasingly expensive only the wealthy will be able to afford to drive. Policyholders may reduce their third-party (Optional) coverage, leaving them at risk of crippling financial consequences of an at-fault crash where the award is higher than their coverage limit.

The EY report does not discuss these social/fairness issues when it proposes the three cap options, or the full no-fault option, to reduce the Basic funding gap.

ADOPT SASKATCHEWAN'S DUAL MODEL

[7] EY Report, p. 116.

[8] https://www.biv.com/article/2017/3/exploring-many-fault-lines-no-fault-insurance-bc/

In contemplating a change to the current full tort insurance model, the government should adopt the dual Basic insurance system that has been operating in Saskatchewan since 2002.

The public auto insurance model in Saskatchewan (Auto Fund) offers policyholders the choice of either the full tort coverage, or a no-fault package. The annual premium is the same for both, but the no-fault package offers much higher defined accident benefits limits, but the not at-fault party cannot sue for pain and suffering.[9]

The dual system would address the plaintiff bar's concern about denying potential victims access to justice, as policyholders could continue with the current Basic tort coverage, or choose the no-fault option. Over 95% of the compulsory policies in Saskatchewan are the no-fault package.

The Basic insurance program in Saskatchewan operates with a 100% capital ratio and is in a satisfactory financial condition, with cumulative rate increases of less than 10 % from 2012 to 2017. ICBC's Basic program, despite cumulative rate increases of about 35% during the same period, is losing hundreds of millions annually, and the capital reserve is falling well below 100% minimum regulatory target.

Allowing for phase-in, it is reasonable to assume that if 50% of ICBC's Basic policies were the enhance no-fault package the injury savings could be in the range of $500 to $600 million, with additional savings in the Optional program as well. ICBC should be directed to provide an estimate of the costs and savings to both programs if the Auto Fund dual model was adopted.

 http://www.bcpolicyperspectives.com/

The writer is a retired senior BC government public servant whose paper describing the BC government's manipulation of the finances of BC Hydro from 2008 to 2014 was published by *BC Studies* in November 2016. *BC Studies* published his paper on the 40-year financial history of ICBC in 2013. He has been an intervener in the BC Utilities Commission's recent reviews of ICBC's rate requests, and is an intervener in the Commission's current review BC Hydro's rate request.

[9] Specific details can be found at https://www.sgi.sk.ca/individuals/registration/personalautoinjury/choosinginjuryinsurance/nofaultandtortbenefits.html

APPENDIX 1

A CLOSER LOOK AT THE INJURY CLAIM ESTIMATES

The EY report (page 23) states that Basic injury claim costs totalled $2.37 billion (it is unclear whether this is for 2016 policy or calendar year).

While not stated, I assume these are settled claims and not an estimate of incurred claims.

The breakdown is shown as:	Minor Injury	$718 million
	Non-Minor Injury	$612 million
	Accident Benefits	$199 million
	Legal Costs, incl. ICBC	$845 million
	Total	$2,374 million

No definition of "minor injury" was provided, but historically ICBC has used a $40,000 cut-off to separate minor from non-minor injury claims.

The report uses the high proportion payments to minor claims as a basis for saying that the BC insurance model needs to focus on reducing the payments for minor claims to achieve the goal of affordability. "There is a finite limit to the level of premiums (i.e., affordability), and so the question becomes, what percentage of claims costs should be paid to minor claims? Many governments have taken the policy decision not to reduce the benefits paid to non-minor injuries to any material extent and to target reductions in benefits to minor injuries; this is a key policy issue and a social policy outcome the government needs to consider."[10]

The growth in minor injury claims in recent years has been a major contributing factor to the pressure on Basic rates. It is important for decision makers to have a good appreciation as to the saving that could be realized if some form of cap on these pain and suffering claims was legislated.

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[10] http://www.icbc.com/about-icbc/company-info/Documents/Affordable-and-Effective-AutoInsurance-Report.pdf p. 91.

The EY report suggests that the potential savings are large, depending on the level of a cap (options 1 to 3 are variations on the theme).

I believe the savings are over-stated.

A comparison of the bodily injury **paid claims** for 2015 is instructive. Table A-1 shows that approximately $1.7 billion was paid in 2015, including $928 for general and special damages (including plaintiff legal fees and disbursements), compared to the $2.37 used by EY for 2016.

Table A-1 VALUE OF BI CLAIMS SETTLED ($=millions)

	2012	2015	CHANGE	PERCENT
General&Special Damages	757.1	928.2	171.7	22.6
Part 7 Benefits	446.8	465.5	18.7	4.2
ICBC Defense Costs	284.3	308.5	24.2	8.5
TOTAL PAYMENTS	**1,488.2**	**1,702.2**	**214.0**	**14.4**

Source: BCUC, ICBC 2016 RRA, IR1, BCUC 13.4.

Of note is the $308.5 million for ICBC defense costs. EY states the 2016 combined legal costs were $845 million. Therefore, subtracting say $335 million for ICBC's 2016 defense costs leaves $510 million for plaintiff legal costs, which is the 33% maximum allowable. This suggests that EY assumed that all claimants had legal representation.

ICBC also provided information for minor soft tissue injury (MSTI) paid claims. Table A-2 shows the number and amount paid for MSTI and non-MSTI claims for 2015.

TABLE A-2 NUMBER AND VALUE OF CLAIMS SETTLED

Injury Claims Type	Exposures	$=million
Minor Soft Tissue	25,192	285.1
All Other	22,014	1,426.5
Total	47,206	1,711.6

Source; BCUC, ICBC 2016 RRA, IR1, RM 3.4 to 4.1

The most common form of minor pain and suffering claim is for soft tissue injury (whiplash). In 2015, ICBC paid some $285 million for such claims (including legal fees), yet the EY report states that the cost of minor injury claims was approximately $955 million ($718 million plus 33% legal fees).

Of the $285 million paid in 2015, approximately $104 million was paid to approximately 16,680 claimants not represented by a lawyer, while approximately $181 million was paid to some 5,330 claimants who did have legal representation.[11]

[11] http://www.bcuc.com/Documents/Proceedings/2016/DOC_47830_B-2_ICBC-IR-No-1.pdf, See RM 3.4 to 4.1.

It appears that the EY figures significantly over-state the cost of the minor injury claims, and the benefits of capping these claims. Further information on the 2015 settled claims can be found in my paper "Rise in Basic Claims Costs: A Statistical Summary 2012 to 2015 and Outlook."[12]

[12] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_18_11_december_2016_3/pdf