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SOME THOUGHTS ON RECENT EVENTS CONCERNING ICBC

During the last two weeks ICBC's future rates and finances became a major issue of public and media attention. Rob Shaw of the *Vancouver Sun* exposed ICBC's reluctance to publicly file a financial forecast as requested by the BC Utilities Commission. When a forecast was filed, the government tried to diffuse the growing concern by announcing a confusing vehicle exclusion policy change, hinted at more changes, and promised not to appropriate further capital funds.

The following are my thoughts on some of the events and implications for the future.

ICBC's Five Year Forecast

On 14 November 2016, the BC Utilities Commission denied ICBC's request to keep its multi-year Basic rate forecast confidential, and ordered ICBC to file within two days. Three days later ICBC requested a five-day extension to consider its options. On 23 November 2016, while the government staged a media event to announce changes to coverage of luxury vehicles, ICBC filed the forecast.

The forecast is based on a *status quo* assumption, and shows annual growth in average claims costs of between 5.2% and 6.3%, which is about three times the rate of general inflation. As I noted in a recent paper, the cumulative increase for the next four years is **35.5%**, but without the transfer of $1.5 billion of funding from "other sources" the four-year cumulative increase is forecast at **55.4%**.[1]

The forecast is based on the policy year (November to October). The government requires that the Basic capital reserve ratio stay at or above a ratio of 100%, especially at fiscal year-end (March 31st). Because the forecast is by policy year it does not address how the suggested 6.4% increase in November 2017, even with the proposed $330 million transfer from "other sources," will achieve the 2017/18 fiscal year-end capital ratio requirement.

By the end of the current fiscal year the Basic and Optional capital ratios will be at their regulatory minimums, leaving little buffer to ensure that ICBC has enough funds to pay current and future claims. Without a massive increase in Basic rates on 1 November 2017[2], the government will need to lower the Optional minimum ratio even further, to transfer more policyholders' "savings" to subsidize the suppressed Basic rates. The lower capital reserves would raise the risk of defaulting on claims payments even higher, further undermining ICBC's finances. Then the same funding issue must then be faced for 2018/19.

The day after the luxury car media event, the government tried to defuse public criticism of its appropriation of $1.2 billion of ICBC's "excess" capital reserves by declaring that no further "dividend"

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[1] See http://www.bcpolicyperspectives.com/media/attachments/view/doc/bcuc_icbc_2016_rra_5_year_forecast_24_november_2016/pdf

[2] See http://www.timescolonist.com/opinion/op-ed/comment-be-prepared-for-icbc-rate-increase-shock-1.3101218

was expected during the next two years.[3] Barry Penner, the ICBC board chair, confused matters by referring to the capital appropriations as a dividend; and the government's pledge was meaningless as there will not be any "excess" Optional capital to take during the foreseeable future.

Excluding Luxury Vehicles

Knowledgeable commentators have already noted that the government's announcement that ICBC will no longer insure luxury vehicles for at fault damage claims will not reduce Basic claims costs, since to insure one's personal vehicle for an at fault claim requires the purchase of an Optional policy.[4]

The make and model of the insured vehicle is only one component included in the calculation of the annual insurance premium. It should be noted that while most insurers annually re-balance the vehicle risk weighting, ICBC has not done so for four years.[5]

The government's announcement, ill-conceived as it was, raises a more serious question. The concept of insurance is to spread the risk of loss as widely as possible, thereby reducing the cost to any individual. To function properly, an insurance plan must ensure that the risk is priced correctly. The answer to a perceived imbalance in the risk and cost is to adjust the cost, rather than lower the risk through exclusion of a class of vehicle.

The notion of exclusion, or discrimination, is incompatible with the concept of universal compulsory insurance. It opens the gate for future discrimination. Which class of vehicle owner will be cast adrift during the next financial storm; those owning vehicles valued at above $60,000? What about drivers over 75? Why not red-heads?

If the government is truly concerned about the projected growth in rates it should focus on reducing the frequency and severity of crashes, and reimburse ICBC for the costs of programs that are the responsibility of government, or for which the government receives the financial benefit. Ill-conceived publicity stunts only distract public discussion from the fundamental issues.

Using Vehicle Insurance Rates for Political Advantage

Most commentators have suggested that the government's attempt to keep ICBC's rate forecasts confidential is to avoid causing public alarm in the months leading to the May 2017 election. This would not be the first time that a government has manipulated ICBC rates to seek political advantage.

In 2003, Gary Collins, the Liberal finance minister, defending the government's decision to have the BC Utilities Commission regulate the Basic insurance program, thereby de-politicizing rate-setting, said; "It will probably take politicians a while to get used to not telling ICBC what to do all the time…."[6]

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[3] http://vancouversun.com/news/local-news/government-vows-to-keep-hands-off-icbc-profits-for-at-least-three-years

[4] See http://vancouversun.com/news/local-news/confusion-lack-of-detail-plague-icbc-changes-on-luxury-autos

[5] Depending on the health of the economy, about 5% to 7% of the total insured private vehicles are new; therefore, in four years approximately 20% to 24% of ICBC's insured fleet has not been specifically risk weighted.

[6] Richard C. McCandless, "Politics and Public Auto Insurance in British Columbia, 1970 to 2010," *BC Studies*, No. 178, Summer 2013, p 109. See http://www.bcpolicyperspectives.com/

Unfortunately, it wasn't long before the new government was doing what previous governments found so appealing.

In many ways, the current rate suppression policy is akin to the situation in 1975. In a period of double digit inflation, the NDP government refused to raise rates, fearing the negative consequences during an election year. Opposition leader Bill Bennett accused the government of calling an election "out of fear of the true facts being made public before the public could have a chance to assess them on their record and wipe them out forever."[7]

When the new Bill Bennett government discovered the size of ICBC's structural deficit (about $1.2 billion in today's dollars) he ordered a massive increase in rates. This touched off public protests across the province, forcing the government to moderate the rate increase and provide a tax-payer bailout to stabilize ICBC's finances. Byron Straight, the government appointed accountant, recommended a restructuring of ICBC's coverage. He also recommended that there be a clear separation between ICBC and the government.

During the next decades, the government found it convenient to use ICBC as a source of funds for traffic safety programs and for enhanced traffic enforcement. When the NDP returned to power in 1991 they found that the previous government had kept rates below costs, resulting in a forecast deficit of $180 million. Finance minister Glen Clark accused the previous government of over-riding ICBC management and manipulating insurance rates for political purposes.[8]

Prior to the 1996 election, with Glen Clark now the premier, the government imposed a three-year freeze on rate increases for BC Hydro and ICBC, and won re-election. In the late 1990s a decline in claims costs allowed the government to send out "safe driver' rebates prior to the 2001 election, but the government was defeated by the Liberals with Gordon Campbell becoming premier.

The Liberal government, as previously noted, claimed its restructuring of ICBC's programs would de-politicalize the public insurer, although Optional and Basic rates were raised substantially during the next three years. Basic rates, the government said, would be set by the independent Utilities Commission in an open and transparent manner.

Following the 2008 world financial crisis the government became desperate for new sources of funds. In 2010 it began to appropriate the "excess" Optional capital to offset some of the government's borrowing costs. It also restricted the BC Utilities Commission's authority to set the Basic capital targets. In 2013, cabinet imposed a form or price control on Basic rate increases, to "smooth" annual changes. Unfortunately, in the name of affordability the government lowered the accumulated savings of ICBC's policyholders to subsidize the Basic rates.

By the end of the current year, the government will have expended some $1.4 billion of ICBC's policyholders' accumulated capital reserve to suppress Basic rates, leaving the reserve ratios at their lowest level in over a decade.

[7] Ibid., p 100.
[8] Ibid., p. 105.

Assigning Responsibility For Adjusting ICBC Rates

Governments have been accused of undue interference in the rate-setting process for ICBC's insurance programs. The BC Utilities Commission was supposed to take politics out of rate setting decisions for both ICBC and BC Hydro, but the Commission has been side-lined or so circumscribed as to make it an agent of the government.[9]

In its 2014 report, the independent task force established to review the operation of the BC Utilities Commission recommended that the government set broad priorities and leave specific matters, including rate-setting, to a strengthen Utilities Commission. The government has ignored this report.

Perhaps the real question is whether it is realistic to expect a democratically elected government to turn over key decisions affecting millions of voters to a group of "un-elected bureaucrats and lawyers"[10] and expect to remain sheltered from the political repercussions.

Independent regulatory bodies generally control private utilities that are trying to use their market power to maximize the financial return to their investors. They have a more difficult time dealing with public utilities where the government shareholder may be trying to minimize the rates charged to customers, who are voters, for a perceived political advantage.

In Saskatchewan, the public auto insurer must submit its annual rate change proposal to the provincial rate review agency, which applies a detailed and transparent review of the rationale. The review board then makes a rate change recommendation to cabinet for decision. Cabinet is responsible for the decision, but given the process followed, the onus is on the government to explain if it deviates from the recommendation of the independent reviewing agency.

The Saskatchewan model achieves the goals of transparency and accountability. The government is ultimately responsible.

Expand the Utilities Commission's Review Authority

The current model assumes that Basic policyholders are separate and distinct from Optional policyholders. The Utilities Commission is nominally responsible for setting the price of the compulsory Basic program, while Optional rates are supposed to respond to market forces. This model never reflected reality, as most Basic policyholders purchase their extended insurance from ICBC. The two programs separate accounts and separate capital reserves, but ICBC operates as a unified organization and manages its assets as a combined whole.

All of ICBC's Optional policyholders are Basic policyholders, and it is unlikely that they make the distinction between the cost and coverage of Basic and Optional insurance. The government, when announcing annual rate changes, combines the effects of the Basic and Optional changes to moderate the impact on the individual policyholder.

[9] See the paper by Rowland Harrison (page 73) included with the 2014 report of the task force established to review the operation of the BC Utilities Commission; http://www2.gov.bc.ca/assets/gov/farming-natural-resources-and-industry/electricity-alternative-energy/electricity/bcuc_review_final_report_nov_14_final.pdf

[10] Liberal minister Bill Bennett's phrase; see http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_15_bcuc_independence_27_october_2016/pdf

Since 2012, the government has been using the policyholders' Optional capital savings to suppress the true price of the policyholders' Basic insurance; essentially using savings to continue an unstainable lifestyle.

For these reasons, the BC Utilities Commission should be given the authority to oversee and recommend changes in the Optional rates. Alberta expanded the jurisdiction of its insurance regulator in 2015 to include the Optional, non-compulsory coverage. How can the Utilities Commission recommend a Basic funding level when a key source of Basic capital is beyond its authority to review?

The recent multi-year Basic forecast is entirely dependent upon $1.5 billion of external funding, but neither we nor the Utilities Commission have been told the planned source of this money. Without assessing the reliability of the indicated funding any rate approvals are almost meaningless.

© Richard C. McCandless November 26, 2016. See also http://www.bcpolicyperspectives.com/

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