OCCASIONAL PAPER No. 59 ICBC

OBSERVATIONS ON ICBC's NEW BASIC PREMIUM MODEL: YOUNGER AND HIGHER RISK DRIVERS TO FACE RATE SHOCK NEXT YEAR

Last week the government announced complex and sweeping changes to the formula used to calculate Basic insurance premiums.[1] The new scheme is designed to apportion a greater share of Basic premium revenue to less experienced (meaning newer and younger) drivers, and to those who have caused accidents than is currently the practice. Implementation is planned for September 2019, subject to the approval of the regulator.

The current model for determining a policyholder's Basic insurance premium had not been seriously reviewed since 2007 and was overdue for an adjustment.[2] The question is whether the proposed changes go too far in attempting to find a fair and reasonable balance between rates charged to low and higher risk drivers/vehicle owners.

Might resulting affordability issues lead to an increase in the incidence of individuals driving without insurance, thereby negating any perceived benefit from the planned readjustment between lower and higher risk drivers by driving up costs to the medical services plan? Will the changes remain revenue neutral once more years of at-fault claims are included in the premium calculation? Will the higher rates further discourage younger drivers from purchasing a vehicle, thereby shrinking ICBC's revenue base?

Why Is the Model Changing?

The pricing changes are the second phase of a major overhaul of the finances of our public auto insurer, following the changes to coverage and claims process announced last February. The impetus for the reapportionment of rate design risk appears to be a wide-spread public perception that good drivers are subsidizing bad drivers.[3]

Minister Eby agreed, admitted that the changes were in response to the public perception that the current apportionment of risk was not fair. "We heard from British Columbians that their insurance rates need to be fair and we agree — good drivers shouldn't have to continue paying more to cover the costs for those who cause crashes or present a higher risk on our roads."[4]

[1] https://news.gov.bc.ca/releases/2018AG0064-001561 These were the most fundamental changes since the early 1980's when ICBC adopted the claim rated scale; see Appendix.
[2] A short history of the Basic rate design can be found at page 13-3 in http://www.bcuc.com/Documents/Proceedings/2007/DOC_14727_B-1-1_ICBC-Rate_Dsgn_App-Vol1.pdf
[3] http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_results_20_may_2018/pdf/commentary_icbc_results_20_may_2018.pdf
[4] https://news.gov.bc.ca/releases/2018AG0064-001561

Joy MacPhail, ICBC's board chair, noted that the recent public consultation (unsurprisingly) found that most respondents felt higher risk drivers should pay more.[5] "When British Columbians were asked for their feedback on this topic, one message came out loud and clear — lower-risk drivers shouldn't be paying the same as some high-risk drivers. We wholeheartedly agree."

But the government failed to educate the public about the factors involved in the design of the current Basic premium, and why the current balance of premium revenue between low and high-risk drivers is wrong. It seems to have relied on popular belief rather than empirical evidence to claim that the system is unfair to those with a lengthy safe driving record.

The government could have reminded the public that the purpose of insurance is to offer financial protection to an individual affected by an accident by pooling the risk of many who pay a premium to create a fund to pay some (or all) of the losses. An individual policyholder who unintentionally causes harm or loss to others is protected from what could be financial ruin.

A more libertarian approach would see at-fault drivers pay a much higher share of the cost of the damages. This would tend to defeat the purpose of insurance, as the higher premiums would force many out of the pool and raising the cost for those remaining.[6]

How Unfair is the Current Model?

Is the current design is broken? The government says the model is too forgiving (financially generous) for those that have or might cause an accident. It cites the example where an at-fault driver can cause three accidents in a year and still pay the same premium as a driver with a clean record. This is correct, but the government fails to mention that the unfortunate at-fault driver was a low-risk driver who had accumulated 20 or more years of no at-fault claims.[7]

Based on the limited data made available by ICBC, we know that about 80% of all Basic policyholders currently qualify for the maximum 43% safe driver discount.[8] Apparently, the government believes that because so many qualify for the full discount, the current rate-setting formula is unfair to truly low-risk drivers because too many qualify as low-risk. As chair MacPhail said, "Eight out of 10 drivers can't possibly have the same risk profile, especially when crashes on our roads are at an all-time high."[9]

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[5] Ibid.

[6] The debate over health insurance in the United States is an example of the tension between cost (risk) and enrolment. In some parts of the United States auto insurance is so expensive that many drive without it.

[7] The driver has accumulated nine or more years without being liable for a claim.

[8] ICBC has not produced any data to show how often such a situation arises; or the number of two crashes or even one crash per year.

[9] https://www.theglobeandmail.com/canada/british-columbia/article-bcs-auto-insurer-targets-high-risk-drivers-with-overhaul-of/

The details of ICBC's new premium calculation model are explained in more detail in its submission to the B.C. Utilities Commission.[10] Some of the more obvious changes are discussed below.

More Personalized (Complex) Design

Insurers (including ICBC) strive to have a rate structure that distinguishes between identifiable risk characteristics, while being simple enough for customers to understand and support.[11] ICBC's current Basic premium design scheme is complex, involving risk factors relating to the vehicle, the geographic territory, the vehicle use, and the experience and claims record of the owner or principal operator. These factors are generally standard in the auto insurance industry.[12]

By attempting to better personalize[13] the pricing of risk, the proposed rate design is far more complex. The new model is much more financially stringent than the current model, incorporating more weighting for actual at-fault crashes and the assumed risk posed by other less experienced drivers. The plan to count 75% of the principle driver's claims history and 25% on the highest risk other operator (if any) will generate more premium income from the same policy. More potential drivers are included, and new special discounts are bolted on to the framework.

Experienced Drivers Will Pay Less While Inexperienced and Younger Drivers Pay More

The government announcement emphasized that bad drivers will pay more. A close reading reveals that not just the "bad apples" that will pay more; younger less experienced drivers will face higher insurance costs.

In the current model the driver component combines factors for experience and for actual at-fault claims. The new system will lower the discount value of a clean driving year, increase from three to 10 years the "scan" period where an at-fault claim impacts rates, and severely restrict the number of at-fault crashes that are waived due to accumulated claims free driving.

As the total package of changes are designed to be revenue neutral (zero-sum), we can assume that the value of the claim-free discount year will be reduced. This means that younger and less-experienced drivers will pay more and take longer to achieve the same financial saving as they would have under the current model.

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[10] https://www.icbc.com/about-icbc/company-info/Documents/bcuc/ICBC-2018-Basic-Insurance-Rate-Design-Application-Aug15-2018.pdf

[11] http://www.bcuc.com/Documents/Proceedings/2007/DOC_14727_B-1-1_ICBC-Rate_Dsgn_App-Vol1.pdf p. 14-6, pdf 28.

[12] ICBC cannot use age, sex and marital status to set premiums. Private insurers in other provinces do use these factors.

[13] ICBC president Nicolas Jimenez on the Lynda Steele Show, CFAX Radio, 9 August 2018.

In theory, younger and less experienced drivers have a higher risk of causing a crash than older and more experienced drivers. In the early 1980's the government ordered ICBC to stop basing premiums on age, sex and marital status. Instead, ICBC developed the discount/surcharge system (the Claims Rating Scale) based on years of driving and actual claim history.[14]

The new plan appears to shift the premium design towards a greater emphasis on age (driving experience). It also incorporates a significant reduction in the value of a good driving record (as at-fault waivers fewer and take longer to accumulate). The harsher treatment of inexperienced drivers who cause a crash is another example of how the new model will make insurance more expensive for younger drivers.[15]

The proportion of ICBC's policyholders aged 25 and younger have been declining,[16] and these changes (which increase the cost to insure a vehicle) will discourage younger drivers from owning and operating a vehicle. This has significant longer-term implications for ICBC's operations.

At-Fault Crashes and High Risk Behaviour Will Cost More

The proposal calls for the replacement of the current discount/surcharge factor with a more complex ratings matrix which is much less forgiving to those drivers who are at-fault in a crash. More claim-free driving years will be required to earn a crash waiver, and a financial penalty surcharge will now last for 10 years.

The briefing material said that the changes are designed to be revenue neutral, with 67% of policyholders receiving a financial benefit in the first year.[17] The shift to scanning a 10-year claims history for at-fault claims (increased from three years) will reduce the percentage qualifying for a financial benefit over the next nine years. This change alone should, all else being equal, generate a significant increase in premium revenue as the new model moves to a steady state.

ICBC's sixth hypothetical customer impact example shows "Jasmine" paying $107 more in the first year because she incurred two at-fault crashes.[18] The first crash penalty was

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[14] The public insurers in Saskatchewan and Manitoba use a similar system.

[15] https://www.icbc.com/about-icbc/changing-auto-insurance-BC/Pages/making-rates-more-fair.aspx

[16] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_4_22_august_2016/pdf/occasional_paper_no_4_22_august_2016.pdf

[17] https://news.gov.bc.ca/releases/2018AG0064-001561

[18] https://www.icbc.com/about-icbc/changing-auto-insurance-BC/Documents/customer-examples.pdf Under the current CRS she would have the second crash "waived" as well.

16 The change to a single crash forgiveness factor in 20 years is less generous than the 13 years in the current model.

waived because of her 30 claim-free driving years,[19] but she will now pay a diminishing financial penalty for the next nine years (increased from three years for most drivers) until the 10-year scan period is again clear.

As Les Leyne suggested, the longer scan period will reduce the number of policyholders receiving a full discount and may result in more premium income to help balance ICBC's bottom line in future years.[20]

Urban Drivers Will Pay More

Vehicle (make, model and age) and territory risk weightings have not been revised in many years. ICBC has implied that due to congestion and other issues those living in the larger urban centres will be paying more under the new system. This is in keeping with the fact that most crashes take place in intersections.

The Seniors' Discount Is Reduced

Those 65 and older who drive for pleasure use receive a 25% discount on their Basic insurance. The cost of the government ordered subsidy (approximately $120 million) is paid by those policyholders under 65.

The government intends to reduce the discount to 15% but is not offering to pay the cost as it does with the seniors' discount at BC Ferries.[21] The discount will now be linked to the driving record, which is contrary to the original purpose of the discount and equates to double jeopardy as an at-fault senior driver may lose the experience credit as well as some or all of the seniors' discount.

Significant Numbers of Policyholders to Experience Rate Shock

The government announcement stated that in the first year of the transition to the new formula (the at-fault crash penalties will take 10 years to develop) some 15% of policyholders (approximately 420,000 policyholders) would see a price reduction of more than $100. However, some 17% (about 480,000) will see an increase of more than $100.

Older drivers are likely more politically active (greater propensity to vote) than younger drivers, so the redistribution of risk will probably be a political winner. The fact that those facing higher rates will renew their policies at various times during the year should defuse their criticism of the new rate structure. A 20% single year rate increase cap is in place for the worst cases.

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[20] https://www.timescolonist.com/opinion/columnists/les-leyne-fine-tuning-the-icbc-fiddle-1.23396831
[21] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_55_9_april_2018/pdf/occasional_paper_no_55_9_april_2018.pdf

This shift to more and longer lasting financial penalties for at-fault claims and less generous discounts will allow additional revenue to be redirected fund greater benefits to older and safer drivers, and to fund the new discounts for braking systems and kilometers driven.

Financial penalties for Risky Behaviour to Jump 40%

The government used the rate redesign opportunity to reaffirm that the financial penalties associated with the driver licence based penalty point and risk premium programs will increase by 40% over the next two years. The penalty points are assessed on driving related convictions, which are indicators of risky behaviour and the propensity to cause a crash.

The significant increase in the financial penalties will affect some 68,000 drivers and add approximately $10 million in revenue to ICBC.[22] The financial shock will be lessened as the payment date for the penalty (driver license) will usually be different than for the vehicle insurance.

Good Politics and Good Public Policy?

The general reaction to the proposal to increase the financial cost to younger drivers and those with at-fault claims to reduce the cost to older and lower risk drivers has generally been well received.[23] But making insurance more expensive for inexperienced driver, where the bar has been raised to 15 years from 9 year, and dramatically increasing other penalties for at-fault crashes or the accumulation of traffic violations, raises longer-term issues.

The changes will result in a significant financial shift from less wealthy younger to more wealthy older policyholders. The higher cost of insurance will discourage younger drivers from purchasing and insuring a vehicle, which has longer-term implications for ICBC's revenue.

While many will consider a significant increase in the cost of insurance and penalty point fines for younger (higher risk) drivers entirely appropriate, the government must be careful to avoid the dangers posed by a significant decrease in the affordability of auto insurance. Low income individuals will find it more expensive to travel to work, while the medical services costs may increase as more individuals drive without insurance.

The government has capped any single year rate increase and expects a full transition to the new model will take three years. One hopes that ICBC will produce public reports in enough detail to monitor the actual effects of the new framework. In such a complex

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[22] https://vancouversun.com/opinion/columnists/vaughn-palmer-many-drivers-can-expect-rate-shocks-despite-those-reduction-promises?video_autoplay=true

[23] https://vancouversun.com/opinion/op-ed/editorial-you-wont-pay-less-for-auto-insurance-but-system-is-fairer

model it will be difficult to identify and adjust key factors if the actual results produce unplanned and unintended consequences.

 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 both ICBC's and BC Hydro's rate requests.

APPENDIX

ICBC's Claims Rating Scale, 1982 to 2007.

Excerpts from ICBC's 2007 rate design request filed with the B.C. Utilities Commission on 29 March 2007:

http://www.bcuc.com/Documents/Proceedings/2007/DOC_14727_B-1-1_ICBC-Rate_Dsgn_App-Vol1.pdf

Claim-Rated Scale (CRS)

When the principles of the Fundamental Automobile Insurance Rating program were incorporated, ICBC needed a new way of taking driver risk characteristics into account in its pricing. With DPP already in place to charge a premium based on points accumulated on the driver's licence, ICBC developed a "bonus-malus" system, similar to that prevalent in continental Europe at the time, which adjusted the premium paid by a customer according to his or her individual claims history by rewarding customers with claims-free experiences and penalizing those with at-fault claims. ICBC adopted the name Claim-Rated Scale for its bonus-malus system when it was implemented in 1982, changing the original Safe Driver Vehicle Discounts to 10%, 20% and 30% and adding a fourth year claims-free premium discount of 35%, as well as surcharges for those responsible for multiple chargeable claims.[16] *page 14-6 pdf 28/220.*

The CRS remained relatively unchanged for almost 20 years. On January 1, 2001, ICBC implemented a significant rate structure change to rebalance the CRS discount levels and address some inherent structural deficiencies that had arisen over time.[18] Under the new Alternate Claim-Rated Scale (ACRS), discount and surcharge entitlement was readjusted to reflect actual loss ratios more accurately and with greater sustainability by slowing the discount growth from 10% increments for the first four years to 5% increments for the first eight years (see Figure 14.2 for the ACRS system that ICBC currently uses in its rate structure and Chapter 16.2 of the Application for an explanation of the process of managing the ACRS changes; further details are in Schedule D of the Basic Insurance Tariff in Appendix 18 B). Transition rules were put in place to limit the impacts of the ACRS changes for customers who did not have any chargeable claims.

Under the original CRS, anyone who had a chargeable claim was treated the same, regardless of the number of years of claims-free driving the customer had accumulated (e.g., any customer at the maximum 40% discount level moved to a 10% discount after one chargeable claim). Under the new ACRS, however, the penalty for a chargeable claim now depends on the position of the policy on the CRS, with a far greater premium impact for a policy at a surcharge level than for a policy with more than 15 years with no chargeable claims. Section C.1.5 below describes how the CRS functions at present as part of ICBC's current rate structure. *page 14-7 pdf 29/220.*