BRITISH COLUMBIA UTILITIES COMMISSION

IN THE MATTER OF

An Application by the Insurance Corporation of British Columbia (ICBC)
for the approval of the
2006 Revenue Requirements for Universal Compulsory Automobile Insurance

and

A Filing to ICBC's Basic Insurance Capital Management Plan

And

An Application for Approval of Refinements to Certain Performance Measures

And

A filling of Information on Seven Financial Allocation Functions and
An application for Approval of Changes to Certain Allocation Functions

SUBMISSIONS OF
PEMBERTON INSURANCE CORPERATION

May 3, 2006

Submissions of
Pemberton Insurance Corporation

Introduction

Our participation as an Intervenor in what is generally known as the 2006 Revenue Requirements of ICBC has concentrated on the subjects of (1) the rate increase, (2) performance measures, and (3) alternatives to broker distribution sections of ICBC's application. During the course of our participation, we have submitted written and oral information requests, provided Intervenor evidence, responded to ICBC's information requests of our evidence, attended the oral public hearings, participated in the cross examination of two panels, and have prepared this written argument submission

We continue to take great interest in the regulation of ICBC's business, particularly in context with the two principles we espouse: One, to provide the best possible value for the provision of the monopolized basic insurance, and two, to ensure there is a level playing field for all participants in the provision of the competitive optional Insurance for motorists.

I. Rate Increase

We see the application for the application for the rate increase to be a function of the two distinct components. The first is the apparent actuarial driven requirements ("the 4.2% increase") and the other being the capital assessment ("the 2.3% increase"). We shall address each of these separately.

a. The Apparent Actuarial Requirement – "The 4.2% Increase"

Throughout the hearings, examples of the subjectivity of actuarial "Science" became apparent. Of particular note were estimations of Loss Development Factors ("LDF's"), multipliers used by ICBC's actuaries to determine a future value, with interpretation and statistical projection based on past trends. We heard that there are some 153 different factors which could have a bearing on any particular LDF outcome, and we also heard that through the variance of some of the input data, that in fact the actuarial driven requirement portion of the rate increase could be as low as 3%, which is in contrast to The 4.2% Increase.

We express concern about the subjectivity of these factors. As an example, let us just take a single factor which we conjecture may have an impact on the claims payouts, and in turn the revenue requirements at ICBC: the current record high price of gasoline. It would be reasonable to conclude that record high prices for gasoline would result in less driving; less driving, and particularly during summer long weekends – where people may decide to stay at home rather then to travel to a weekend destination – would imply less vehicles on the road; less vehicles on the road would mean that there would be less congestion and therefore a lower accident rate. We wonder how this is factored in to the 2006 Revenue Requirements, and quite frankly given that ICBC earns its premiums over a 24 month period, how is this being factored into the both the 2005 and 2004 results?

What is become clear to us is that the British Columbia Utilities Commission must get a grip on ICBC's actuarial practice and methodology to determine LDF's. It is our submission that an application process for the determination of LDF's and related methodology be ordered and be brought before a future hearing.

In respect of another issue, the possible change to the court tariff that consists of approximately 0.2% of the applied increase has been included as a cost that in fact does not even exist. This is evidenced by correspondence written by the Deputy Attorney General that an increase has not been promulgated and must first be approved by the Provincial Executive Council. We see no reason to have such a mythical cost factored in at this time, and consideration of such a future cost should be properly given if and at the time when the court tariff changes are brought into force.

b. <u>Capital Build - "The 2.3% Increse"</u>

During the course of our cross examination of the financial panel, our efforts focused on the validity for the apparent need to assess policyholders for a capital build provision. We have been disappointed that in the haste of the rate increase, ICBC has not done its homework and has failed to use effort, innovation, and enterprise to pursue other ways to achieve the Minimum Capital Test levels required for the year 2014 outlined by Special Directive IC-2. We specifically identified two obvious and very viable alternatives – one being share issuance, and the other an arrangement of Quota Share Reinsurance.

i. <u>Share Issuance Alternative</u>

One of the fundamental methods that any business, and more generally a Financial Institution, and specifically an Insurance Company capitalizes itself is with the issuance of shares. In our information request to ICBC on the subject we asked:

> *Please provide information as to discussions and evaluations of alternate capital plans, with specific reference to accessing external sources of capital from alternative providers of capital, including both government and private sources.*[1]

In a lame response, ICBC stated:

> *"ICBC has not pursued or evaluated alternative capital plans… and therefore securing additional capital from government is not warranted. Although section 18 of the Insurance Corporation Act, (RSBC 1996 Chapter 228) gives ICBC the power to borrow, securing capital through private sources would result in additional costs in terms of interest payments or dividends…"*

Pemberton Insurance Corporation submitted intervener evidence, which stated

> *Instead of assessing an ICBC customer for a capital assessment, ICBC could tap equity or re-insurance markets for capital support. Such a revision to the plan would leave the policyholder assessment to simply be a cost of capital. We believe that the cost of capital could be obtained for as little as 13¢ on the dollar, thus reducing the impact of the "Capital Build" burden on policyholders by 87%.*[2]

We went on to provided additional evidence on the same exhibit that further stated:

[1] IR 2006.1 PI.1.2
[2] Exhibit C15-6, Item no. 1

The supply of private capital from individuals, institutions, and pension funds in Canada for stable and mature insurance companies businesses like ICBC is strong. As a matter of fact, ING Canada set the bellwether standard last year for an Initial Public Offering (IPO) with a "Made in Canada" mid market common share issuance. Demand was so great, it was reported to be oversubscribed six-times. The share price in the after-market rose with substantial support. (Attached Exhibit)[3]

We took note that ICBC declined its prerogative to cross-examine us on this factual evidence, and has accepted the matter by estoppel.

We also presented the subject matter in cross examination to ICBC's external actuary, and in reference to the issuance of common shares raising the MCT result, he agreed:

MR. FINNIE: Q: Specifically and in reference of the management of an insurer's affairs, business affairs, would the proceeds of an issuance of common shares to an insurer's capital account increase the MCT result?

MR. WEILAND: A: If the share issuance increased the equity in the company, then the capital available would rise, and that would improve the MCT ratio, would raise it.[4]

We further cross examined the chief actuary on respect of the viability of issuing preferred shares, eligible for MCT inclusion by OSFI standards. In the section of transcripts ICBC agreed that with the issuance of share, not only would the MCT rise, but also that the 2.3% capital assessment would be unnecessary.

MR. FINNIE: Q: And you said earlier, the issuance of either or both common shares or eligible preferred shares -- shares -- would indeed increase the MCT. Is that not correct?

MR. WEILAND: A: That is correct.

MR. FINNIE: Q: Okay. So if ICBC issued -- raised financing through the issuance of one of those forms of equity –

MR. WEILAND: A: Mm-hmm.

MR. FINNIE: Q: -- it seems intuitive to us that they wouldn't need this 2.3 percent increase on the premiums, that portion of it.[5]

ii. <u>Quota Share Reinsurance Alternative</u>

Another easily accessible arrangement to enhance the value of the Minimum Capital Test is to enter into an arrangement of Quota Share Reinsurance. In such an arrangement the MCT value would increase and the 2.3% capital assessment rate increase would not be required. ICBC's external actuary agreed that the MCT result would increase with

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[3] Exhibit C15-6, Item no. 2
[4] Tr. 4, P 562, L 16-23
[5] Tr. 4, P 565, L 11-22

an arrangement of Quota Share Reinsurance, and also agreed that it is possible to construct an arrangement which would negate the need for the 2.3% portion of the rate increase.

> *MR. FINNIE: Q: Is it possible that a sufficient amount of quota share reinsurance could eliminate the need for the 2.3 percent capital assessment?*
>
> *MR. WEILAND: A: You may be able to construct a scenario where that would -- that would be the case. Whether you could actually place such reinsurance in the marketplace is -- is another question. But I'm sure that you could construct a scenario that would accomplish it. But you'd have to sell it to a third party.*[6]

Pemberton Insurance Corporation submits that such reinsurance is widely available and in our opinion as insurance brokers, we believe that such a treaty could easily be obtained in the domestic or international marketplace for ICBC. This kind of reinsurance is placed for many insurance companies around the world, for the purposes to enhance an insurer's capital resources. We further submit that by ICBC entering into an arrangement of quota share reinsurance that it would be a benefit to policy holders as they would not need to pay the 2.3% rate increase for capital build.

iii. Cost of Capital

In our evidence, we suggested that the cost of capital could be obtained for as little as 13 cents on the dollar, and thus reducing the capital build portion by 87%. However it is interesting to note that ICBC believes that such cost of capital could be achieved for a little as approximately 5%. Like ICBC, we concur that there must be a return paid to providers of external capital but we believe that this cost is a far better bargain for policy holders than assessing for the actual capital itself. ICBC's chief actuary discussed the 5% cost under cross examination:

> *MS. MINOGUE: A: One of the significant elements, I'd like to add, too, is the reinsurer's profit. Just like issuing shares, you're going to have to pay dividends to the shareholders. That's going to be a cost to the policyholders. The cost of reinsurance -- they don't do reinsurance for free, and typically on a quota share arrangement, they want five percent. Five percent. That's going to have to be covered by the policyholders in such an arrangement.*[7]

ICBC's chief actuary's testimony confirms the belief of a lower cost of capital which is enjoyed in ICBC priviledged position as having a guarantee as a crowned corporation. We further probed the math on this with ICBC's corporate controller, who confirmed the arithmetic:

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[6] Tr. 4, P 571, L 8-17
[7] Tr. 4, P 570, L 16-24

MR. FINNIE: Q: As a Crown corporation we understand that ICBC can issue government guaranteed obligations. What do you estimate would be such a cost of capital to ICBC?

MR. CHAUDHRY: A: We haven't gone out and tested that, so I can't give you an educated guess at this time.

MR. FINNIE: Q: Would you be fair to say it might be higher than a government Canada Bond, which I think is in the record as 3.67 percent, or maybe closer to the 5 percent used for your investments?

MR. CHAUDHRY: A: We have not tested the market.

MR. FINNIE: Q: Let's assume it was 5 percent, and say ICBC raised $100 million in capital. Do you agree the cost to policy holders would be $5 million a year?

MR. CHAUDHRY: A: I believe your math is correct.[8]

Pemberton Insurance Corporation submits that with the utilization of its Crown guarantee, ICBC can in fact reduce its cost of capital by some 95% in comparison to an assessment of capital, which is undoubtedly to the benefit of policyholders.

For the purposes of rate need recapitulation, we have used an average of the 5% and 13% range of cost of capital figures, being 9%, and have then applied this against the capital build amount of 2.3%, to arrive at an effective cost of capital of 0.2%

Pemberton Insurance Corporation further submits that there is case precedent for crown corporations to access private capital. We believe that in the haste of the January 2006 revision of the August 2005 application, ICBC has failed to adequately consider the alternatives.

MR. FINNIE: Q: During the 1980s, your sister Crown Corporation British Columbia Railway issued preferred shares to finance capital needs. These were publicly traded securities and paid a return to investors. Are you aware of this case study and have you evaluated the similar benefits that could be delivered to ICBC policyholders?

MR. CHAUDHRY: A: Again going back to an earlier comment that I made, we have not pursued any of this because of the Special Direction IC 2.[9]

c. <u>Is the rate increase "Stable and Predictable"?</u>

What we have experienced during the course of this application is a swift and astonishing change in projection for ICBC's bottom line result by deteriorating in a "fast ferry like" proportion of $341,000,000. We would like to analyse the context of this change in terms of the environment and revelations.

8 Tr. 4, P 577, L 13-26; P 578, L 1
9 Tr. 4, P 579, L 13-22

i. Environment

As the Commission is likely aware, there was a pre-emptive strike by ICBC to reduce optional rates last summer, our estimation is that these reductions primarily benefited the "Sweet Spot" of the Claims Rated Scale ("CRS") curve, specifically drivers with several years of experience and low claim frequencies. The approximate order of magnitude of these reductions were 15%, and this measure has reinforced ICBC's dominance in the Optional Insurance sector to the detriment of its private sector competitors – those who are prohibited from providing basic insurance.

Also, there are the negative optics of introducing an increase on the monopolized and mandatory basic insurance business following a decrease on the "competitive" optional business. However this is in the shadow of two important events: the first being the Commission's determination of the Financial Allocation Methodology ("FAMA"), and also following the re-election of the incumbent government for a further 4 year term.

We are concerned about a "FAMA Syndrome" that appears to be developing. This syndrome can best be described as a tilting of the cost scale for certain allocators, particularly those involving premiums. More weight is be given to the basic insurance cost percentage relative to a lower weight being given to the optional insurance percentage cost allocator. By simply decreasing the rates on the optional side, and then increasing the rates on the basic side, this gives an automatic cost advantage boost to ICBC's optional business and when projected forward in time, it becomes a compounding problem.

Although we will further discuss some matters of accounting methodology, in reference to ICBC's capacity as a public crown corporation and as a financial institution, ICBC can construct its books by using subjective reserve determinations and also by timing investment income realization, potentially saving any rate increase until after a general election.

ii. Revelations

We would like to comment on past and former estimates on rate need, as well as retrospective rating:

1. Rate Need

During the course of testimony, ICBC's chief actuary conceded that they "got 2005 wrong" and that there should have been a rate increase for that year of account. There was also a revelation of a 4.8% increase need for 2007. It is revealing that ICBC has already been able to determine the effective result from 2005, and also has been able to estimate at this time, being April 2006, itss revenue requirements for 2007 within one-tenth of a percentage point.

2. Retrospective Rating

In past applications, ICBC has denied that it earns revenues and rates on a retrospective basis, and views its revenue requirements strictly on a prospective basis. We disagree both from the perspective of Prior Years Adjustments, as well as formal Retrospective Fleet Rating plans. We submit that there should be greater transparency.

3. Prior Year Adjustments

Prior year adjustments are charges made to the income statement as a result of under estimated funding for liabilities arising out of policies issued during a period of time that has already lapsed. There is obviously an “Intergenerational” problem, as future premium payers are assessed for past costs raising from claims. This creates a problem of performance measurement and the reward culture that now exists at ICBC.

Pemberton Insurance Corporation submits that an application for rate increase should specifically show the retrospective charge for prior years adjustments, and we also submit that the performance measures at ICBC be more closely tied to the actual outcome of the year of account, as opposed to some other measure which, say, may be based on perhaps on investment income. If ICBC “got it wrong” for the 2005 year, we cannot logically justify supporting bonuses paid.

iii. Discussion & Analysis of ‘Stable and Predictable’

Consumers and individuals have certain expectations about day-to-day costs they incur in life. We think it is fair to say that consumers consider an annual rent increase to be an expectation also that the cost of basic needs such as food, housing, clothing, and utilities to increase year over year and we think consumers expect the price of insurance to also increase year-over-year. We also believe that income earners expect a cost-of-living increase each year.

However, we believe that this expectation is tied to a concept we are all to familiar with called “Inflation” – that if the cost of a product or service increases say 3% year-over-year that this is normal. So perhaps it is safe to say, we can easily submit that inflation is the closest proxy to stability and predictability. Putting this into context with basic automobile insurance, we submit that it is difficult to rationalize a rate freeze for several years, then a spike of approximately 10%, a few more relatively level years, and then a 6 ½ % increase to be stable. We submit that a rate increase in line with inflation is not only stable and predictable, but it can be easily achieved in context with ICBC’s revenue needs.

iv. Rate Increase Recapitulation

In our opinion, we submit that the 2006 Revenue Requirements for ICBC are sufficient at 3.2%, and that the amount applied for is excessive and unwarranted:

Component	PIC	ICBC
Actuarial Need	3.0%	4.0%
Court Tariff Need	0.0%	0.2%
Capital Assessment Need	0.2%	2.3%
Total 2006 Revenue Requirements	3.2%	6.5%

II. Changes to Performance Measures

Pemberton Insurance Corporation submits the all of the current Performance Measures were agreed to in a Negotiated Settlement Process, and that the measure dealing with ‘Complaints to the Fairness Commissioner’ was one of an overall set agreed to by ICBC, the Intervenors and the Commission. In arriving at this particular item, several other

Performance Measures which were proposed and adamantly rejected by ICBC. This was a compromise item.

We are of the opinion that this measure continues to be a statistically relevant measure of severe claims handling issues at ICBC, and should not be expectorated.

III. Alternatives to Broker Distribution

Introduction

In its January 2005 decision, the British Columbia Utilities Commission requested ICBC "to provide enough information for the Commission to determine weather there are acceptable cost effective alternatives to renewal through Brokers." In reviewing this section of the application, we prepared a comprehensive set of information requests and also conducted a cross examination of the panel in order to provide balance to what we perceived as severely slanted and negatively biased material. We were particularly concerned about the lack of objectivity, and the possibility of a hidden agenda arising from the possible loss of control of the Basic, would result in the loss in control in domination of the Optional insurance market place.

In our approach, we covered areas of perceived impediments, insight into the current distribution landscape, probes into potential Internet user flows, and contrast to the economics presented.

a. Perceived Impediments

ICBC identified current operational standards which they portrayed as insurmountable barriers to avoid deviating from the current system of renewals. In particular these were the signature requirements, payment requirements, and decal issuance.

i. Signature

Pemberton Insurance Corporation submits that a signature on the documentation is a redundant exercise and unnecessary. The Basic insurance benefits and obligations are not a contract, but are actually a set of statutory regulations enshrined in legislation. There is no deviation from these terms and conditions, and no negotiation for variance. We have viewed other government insurance plans such as the medical services plan or employment insurance where signatures are certainly not required to effect continuation of coverage. As a matter of fact neither the ICBC underwriting department, nor do ICBC adjusters view ICBC's copy of the written documents, except on rare occasions. This passage of transcript demonstrates the non-reliance of documentation and signatures:

> *MR. FINNIE: Q: Does ICBC even look at renewal policy documentation when a claim happens, given that the appointed agents store these documents on ICBC's behalf?*
>
> *MR. DICKINSON: A: It would be my understanding that if coverage appeared to be in order and that there were no issues, that it would not be looked at. If there was some question as to coverage, or some question as to the insurance transaction, then I would imagine they would be pulled.*
>
> *MR. FINNIE: Q: Does this happen very frequently?*

MR. DICKINSON: A: I don't believe it does.

MR. FINNIE: Q: Should some simple amendments be made to legislation, is it possible that the signature requirements for renewals could become no longer required?

MR. DICKINSON: A: If the legislation is amended, that would be a possibility..."[10]

In a recent decision of the British Columbia Supreme Court, the judge deemed ICBC an agent of government[11]. We can therefore conclude and submit that amendment of signature requirements would be a straightforward process, should ICBC's management have the will or be ordered to do so.

ii. Payment

With the wide variety of payment options which ICBC offers, we submit that barriers presented by payment should not be an issue. The two largest method of payment are the monthly pay plan, representing some 50% of cases, and credit cards. Cheques still present a barrier because of the failure of ICBC to accept post-dated cheques, and of course cash still has to be handles on a manual basis. With the preponderance of renewal payments possible by computer debit, the use of a secure Internet site provides a very sound platform in which to conduct business. ICBC confirmed this to be the case in the transcripts:

MR. FINNIE: Q: Sure. Given that we understand 50 percent of policyholders use the monthly pay plan, and that it has been recently changed, and in-sourced, why is there an exception on this notice to renew form?

MR. DICKINSON: A: Again, I don't have the rationale in front of me, but if -- my understanding would be if you're entering the payment plan, you need to submit banking information such as a voided cheque, to – in order to process the transaction. So I would imagine it would be to ensure that the -- that banking information is correct, and it's coming from the right person.

MR. FINNIE: Q: Is it not the case with renewals of the payment plan that the banking information, account number, transit numbers and banks themselves is already in ICBC's system?

MR. DICKINSON: A: At a renewal, yes, it would be.

MR. FINNIE: Q: Thank you.[12]

In our review of computer systems, we also verified from the head of information technology at ICBC the following:

MR. FINNIE: Q: Could customer payment be easily made by credit card, direct bank account, debit or continuation of a payment plan?

[10] Tr. 6, P 1050, L 14-26 & P 1051, L 1-5
[11] BC Old Age Pensioners v. Minister of Public Safety 2006, L 31
[12] Tr. 6, P 1053, L 3-20 & P 1072, L 1-3

MR. STEWART: A: I think that's a relatively simple and well-defined transaction in the business world today, yes.[13]

iii. Decals

British Columbia has an unusually strict form of decal distribution and licence plating compared to that of other jurisdictions.

There is a distinction for the police to be able to identify a vehicle in contrast to ICBC's interest that is to collect premium:

MR. FINNIE: Q: So there's quite a substantial connection between the decal and the validity of a decal and payment.

MR. DICKINSON: A: There is, and that's unique to only a few jurisdictions in North America where you do have the link of the decal to the basic insurance. It's one of the main reasons why we have such a low uninsured rate compared to other jurisdictions in North America.[14]

Pemberton Insurance Corporation submits that with the universal availability of Basic insurance, the penalties for failing to insure, the rigorous process that takes place with every claim, and the automatic coverage afforded from uninsured drivers, it would be completely illogical, as well as being unlawful, for motorists to drive around uninsured. Quite frankly with the ability to obtain valid licence from any vehicle with the use of a slot screwdriver, a devious individual could quite easily drive on our highways and be undetected by visual police sightings.

Many other jurisdictions mail decals or tags to renew motor vehicle licences – after the motorists have provided proof of vehicle insurance – through the mail system. There are also continuous forms of licence that serve as identification. Pemberton Insurance Corporation submits an opinion that we feel that the first class mail service offered by Canada Post Corporation is secure, reliable, and can be used for the delivery of decals.

We further submit that banks routinely forward credit card renewals by regular first class mail, trust companies and investment firms commonly use regular first class mail to send out stock and bond certificates, and both consumers businesses, and government use regular first class mail to remit millions of cheque payments every year. We are of the opinion that licence plate decals can also benefit from the reliable and cost effective first class mail service offered by Canada Post Corporation.

b. Distribution Landscape

In its material, Pemberton Insurance Corporation explored issues dealing with the unusual environment concerning Autoplan appointments, and distribution domination. We find it anomalistic that 10 agency groups control one-third of ICBC's distribution. Pemberton Insurance Corporation submits that any insurance agent, properly licensed by the Insurance Council of British Columbia, should be able to deal with the renewal of basic insurance. We compare the system that has evolved because of the monopoly and moratorium to be feudal like, where lord-like businesses control the appointments. This is unheard of with in the

[13] Tr. 6, P 1071, L 24-26

[14] Tr. 6, P 1056, L 13-21

insurance industry with other insurer / agency relationships. We are also concerned about the phenomena of a local monopoly, where because of the huge market value just to obtain an aspiring agency could not justify the $350,000 cost, and the local townspeople would be obligated to continue dealing with an incumbent – and without choice.

c. Internet User Flows

We probed the matter of policyholder / vehicle identification, rating criteria, optional coverages, and processing. ICBC agreed with these simple components which would be the framework for an Internet site in the transcripts:

> *MR. FINNIE: Q: ... Mr. Stewart, would you agree that in terms of the current renewal system, there are four component steps: one, identify the policyholder and vehicle; two, address rating criteria; three, deal with optional coverages; and four, process payment, decal, and documentation.*
>
> *MR. STEWART: A: I would agree that those are the major components, with the exception of vehicle licensing and registration, would also be part of that business transaction.*[15]

Mr. Stewart then went on through that balance of questioning to conquer with security, identification protocol, rating ability, optional coverages, and payment as though it were a breeze to ICBC – and in contrast to the information in Chapter 12.

Pemberton Insurance Corporation submits that both a Business to Business, as well as a Consumer to Business Internet renewal system could be established. In the case of a Business to Business facility, which we believe is the first step ICBC should take, a packet of data would be instantaneously transmitted from a provider of Optional insurance which would contain the simple variables and details in order to process the basic insurance transaction. ICBC's systems would then proceed to mail the decal to the policyholder as well as insurance documents (if not already electronically transmitted to the policyholder). As a second priority, ICBC could easily establish a Consumer to Business site, which we submit would be most advantageous to those policyholders who just buy Basic insurance only.

d. Economics

To be frank, we were disappointed in the quality and comprehensiveness of the economics and costing provided in the application, particularly given one of the Commission's directive for cost effectiveness.

Pemberton Insurance Corporation submitted evidence, which was unchallenged by ICBC and has become estopped, contradicting the remuneration of the "$8.60 value" for processing renewals that ICBC imposes on appointed agents without meaningful consultation. Our evidence stated the minimal renewal cost of an appointed agent incurs as $25.86 to perform such services, and ICBC prohibits an agent from charging a further fee[16].

We submit that this cost imbalance most cross subsidization must be corrected, and given that the cost of an agency appointment at $350,000 intuitively suggests that there is a "gold mine" of commission revenues derived from the Optional side of the ICBC business. We

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[15] Tr. 6, P 1066, L 5-16

[16] Exhibit C15-6, Items nos. 5 and 6

further submit that ICBC appointed agents should be able to charge fees to consumers directly for services performed, and a 'net' premium system would then have cost integrity and transparency. In that case the cost is covered through a fee for service relationship between the agent and the customer, rather than non-relational remuneration uniformly paid by ICBC.

In terms of an Internet site set-up capital cost, again we saw loose estimates presented in the application from $1,000,000 to $5,000,000 – a huge range. We believe that a Business to Business basis where secure packets of information are transmitted to ICBC would result in software investment of much less than $1,000,000.

Conclusion

Pemberton Insurance Corporation submits that a lot has changed in the three decades since ICBC established its current system of distribution, and has failed to fully evolve with the advent the Internet age. Banking, investment dealing, the ability to purchase of a wide range of goods and services over the Internet are part of our daily lives. Even ICBC has deployed the internet for the past handful of years to handle its network needs with its appointed agents, and has seen the benefits.

The Internet would empower consumers to choose from potentially three transaction mediums: the current agent distribution; a Business-to-Business renewal via an insured's optional carrier; or a Consumer to Business choice for Basic only cases.

We are of the belief and submit that renewal of basic insurance via the Internet would add complimentary choice, cost effectiveness, and competition in the handling of Basic Insurance renewals.

IV. Other Matters

a. Accounting:

Because of the significant amount of reserving, adjustments, and realization of investment gains, ICBC's financial statements are more of a construction rather than an exercise in cost counting. We would like to provide our comments in regards of investment realizations, Year of Account methodology, retrospective adjustments, and rating issues.

i. Investment Realizations:

Similar to that of an individual who may sell a security prior to a tax year end to either trigger a gain or to benefit from a tax offset because of a loss, based on its current system of accounting, ICBC can also be motivated to do such security selling to arrive at a predetermined year end result. We have commented on prior applications on how remarkably closely ICBC have been able to arrive at a result mandated in its Service Plan, and accordingly question the relevance of continuing to measure ICBC's investment portfolio on an historical cost basis.

The alternative measure to historical cost, is "mark-to-market" in which the investments are shown on the balance sheet at current market price, and differences with a prior valuation are accrued on the income statement.

We have reviewed some of the measures for pension funds regulated by OSFI, whereby tests are performed to determine the soundness of a particular pension plan to meet its obligations. In these tests, it is our understanding that the investments, which fund the obligations, are not valued at cost, but are in fact valued at market value. We have also reviewed the practice of valuation for mutual funds, as well as the usual standards that investments dealers and counnsellors follow in the management of funds. In all cases, a market value standard is used.

It seems to us that the use of historical cost for financial assets on ICBC's books is irrelevant, given the size of its investments holdings, the sophistication of its management, and that returns are derived from dividends, interest, as well as capital gains.   We see no reason why immediate credit should not be taken for capital gains, and for that the case of a declining market, an offset accrued. We should also comment that we believe that the P&C-1 return for MCT calculations follows a market value approach as well. Accordingly Pemberton Insurance Corporation submits that the basis of accounting for ICBC's investments should be changed from historical cost, to a market value basis.

ii. Year of Account

ICBC has provided data and creates reserves to convert premiums that arise out of a certain policy year, and matching claims that relate to those policies, to an annualized form of financial statements. An alternative to this would be a pure "Year of Account" system, similar to that used at Lloyd's. In such a system, each year of account is viewed as a "venture", and is measured accordingly. It is not until the end of 36 months at Lloyd's until the residual liabilities are valued, that a result is rendered. It should also be noted that here in Canada, the Canada Revenue Agency follows a similar year of account basis for the accounting of income tax.

iii. **Retrospective Rating**

We continue to be concerned about charges to the income statement arising from prior years adjustment, which were effectively retrospective adjustments – under funding from prior years. The creep of these adjustments continues to undermine the integrity of prior year revenue requirements, and undermine efforts to properly match costs and revenues to a particular year. We also noted that a formal retrospective rating plan exists for Fleetplan and 3½ years later adjustments are charged to the now current policy year. We have noted this evidence in the transcripts:

> *MR. FINNIE: Q: The final adjustment is a calculation of 42 months from the inception of the policy. If there is a credit, is it netted against current year premiums, or is it included on the prior year adjustments on the financial statements?*
>
> *MR. DICKINSON: A: It is the current year's premium that it is applied to.*[17]

Accordingly, ICBC's revenue requirements not only cover the current year but also catch up amounts from prior years and may cause certain inequities.

b. **Rating**

Commissioner Vivian conducted an insightful line of questioning in respect of itemization of components applicable to a policyholder to fund various aspects of ICBC and also the impact of these items on the premium tax. We conquer that there are components, such as road safety assessments, which like a motor licence fees that are already separately itemized, should not be subject to taxation. We further believe that a capital assessment, if it were to be approved, should be credited directly to the balance sheet, and should be shown on a Notice to Renew form as a separate item and not subject to taxation. If our approaches to utilize capital and in stead have policyholders bear the incidence of a cost of capital, then this would form a part of premium consistent with practice in the industry.

c. **Refunds**

ICBC has proposed a *de minimus* for small refunds, based on the argument of the cost to produce, mail, and bank cheques. We agree that there should be a *de minimus* amount applicable to the production of a cheque, but we disagree that small refunds should automatically become the property of ICBC. Pemberton Insurance Corporation submits that small refunds below a threshold established to produce a cheques established by the Commission should be electronically credited to the policyholders account, and offset against a future transaction. We believe that this would be an economical and efficient way of dealing with the matter.

d. **Claims Reporting**

We have submitted under the distribution system that it is very viable that a Business-to-Business platform be established whereby packet of information be uploaded to ICBC and a Basic insurance renewal be triggered.

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[17] Tr. 6, P 1045, L 26 & P 1046, L 1-6.

Likewise we believe an efficiency can be added in the integration of the automobile insurance industry, by allowing optional insurance providers to upload similar packets of data to ICBC containing claims information. This could be predefined data format, and the information would be similar to that of already contained on ICBC's currently functioning Consumer to Business web site for claims reporting. The benefit to the insured is that the consumer would only have to make one claims report rather than two.

Submission Conclusion

We have covered arguments dealing with the rate increase, performance measures, internet distribution, and other matters in this submission.

The role of the British Columbia Utilities Commission is to act as a guardian of consumer interests, and to protect against the economic power wielded by a monopoly.

Respectfully Submitted

Pemberton Insurance Corporation
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President