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February 25, 2014
File No.: 254656.00118/14797

BY E-MAIL

British Columbia Utilities Commission
6th floor, 900 Howe Street
Vancouver, BC V6Z 2N3

Attention: Erica Hamilton
Commission Secretary

Dear Sirs/Mesdames:

Re: An Application by Insurance Corporation of British Columbia for Approval of the Revenue Requirements for Universal Compulsory Automobile Insurance Effective November 1, 2013 and Approval of a New Basic Insurance Capital Management Plan

We enclose for filing in the above proceeding the Final Submission of the Insurance Corporation of British Columbia dated February 25, 2014.

Six hard copies of the Final Submission will follow by courier.

Yours truly,

FASKEN MARTINEAU DuMOULIN LLP

[original signed by Matthew Ghikas]

Matthew Ghikas

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Enc

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BRITISH COLUMBIA UTILITIES COMMISSION

IN THE MATTER OF THE UTILITIES COMMISSION ACT

R.S.B.C. 1996, CHAPTER 473

and the

INSURANCE CORPORATION ACT

R.S.B.C. 1996, Chapter 228, as amended

AN APPLICATION BY THE INSURANCE CORPORATION OF BRITISH COLUMBIA ("ICBC") FOR APPROVAL OF THE REVENUE REQUIREMENTS FOR UNIVERSAL COMPULSORY AUTOMOBILE INSURANCE EFFECTIVE NOVEMBER 1, 2013

and

FOR APPROVAL OF A NEW BASIC INSURANCE CAPITAL MANAGEMENT PLAN

FINAL SUBMISSION OF

THE INSURANCE CORPORATION OF BRITISH COLUMBIA (ICBC)

February 25, 2014

PART ONE: INTRODUCTION

1. Accepted actuarial practice is the touchstone for the regulation of Basic insurance rates by virtue of *Special Direction IC2*.[1] The application of accepted actuarial practice requires, in essence, that Basic insurance rates reflect the costs of providing Basic insurance, subject to applicable laws.[2] The rate change that would be required to cover costs for the policy year (PY) commencing November 1, 2013 (PY 2013)[3] is 11.5%, driven primarily by expected increases in bodily injury (BI) claims costs and partially offset by forecasted investment income and significant reductions in operating expenses. ICBC's much lower proposed rate change of 4.9% is only made possible by the new legislated rate smoothing framework. It dictates the exclusion of the most significant, and generally the most volatile, component of the actuarial rate indication (the loss cost forecast variance). The proposed rate increase, having been prepared in accordance with accepted actuarial practice and the legislative framework and accounting for all of the steps taken by ICBC to reduce costs, is just and reasonable. ICBC submits that it should be approved on the terms specified in Chapter 1 of the Application.

2. The second aspect of this Application is the proposed Capital Management Plan (CMP). ICBC needs a new CMP for PY 2014 and beyond to give effect to the rate smoothing framework established by *Special Direction IC2* and the *Government directive regarding Rate Smoothing*.[4] The premise of the rate smoothing framework is to use Basic capital to smooth out volatility inherent in the insurance industry, as well as using capital to fulfil its current role of ensuring the long-term financial viability of Basic insurance. This new role for Basic capital

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[1] *Special Direction IC2 to the BC Utilities Commission*, BC Regulation 307/2004 as amended (*Special Direction IC2*), section 3(1)(c).

[2] Application, Chapter 2, para.5.

[3] 2013.1 RR BCUC.5.1 contains an illustrative diagram of how the policies written will be affected by the rate change. Ms. Minogue explained how the rate indication is based on annualized costs, but inflation for only 9 months, so that ICBC was not "putting extra costs in, knowing that we would change rates nine months from now". T4: 524, l.8 to 525, l.3; T4: 555, l.3 to 556, l.2. In light of the February 18, 2014 amendment to *Special Direction IC2* to extend the filing date of the next revenue requirement application to August 31, 2013, the updated information to be submitted in confidential undertaking 2013 RR BCUC.UT.14C will reflect a full 12 months of data.

[4] Government directive of March 19, 2013 with respect to Rate Smoothing approved by Order in Council 153/13, March 18, 2013 (2013 Government Directive regarding Rate Smoothing).

requires managing Basic capital levels to a higher level than is required today for solvency protection. Setting Basic rates below costs, as is contemplated this year (and likely next year), depletes Basic capital. The CMP specifies appropriate terms for re-building capital gradually over time. The CMP also includes the concept of a Customer Renewal Credit (CRC) to act as a release valve in the event of unanticipated growth of excess capital. ICBC submits that the proposed CMP appropriately reflects the requirements of the legislative framework and the risk profile of the Basic insurance business under the rate smoothing framework.[5] It should be approved on the terms sought on or before May 31, 2014.

3. This Final Submission addresses the following matters:

- Part Two addresses the constraints imposed by the legal framework and its favourable implications for the rate indication in PY 2013;
- Part Three summarizes the evidence supporting each of the major components of the requested rate increase;
- Part Four demonstrates that ICBC is taking appropriate steps to manage claims costs;
- Part Five addresses the benefits of streamlining the performance measures;
- Part Six explains why the proposed components of the new Capital Management Plan accord with the legislative framework and make sense in the context of balancing short-term rate impacts and rate smoothing over time; and
- Part Seven, Conclusion and Implementation, addresses implementation of the Commission's final order.

[5] Chapter 2, para.7.

PART TWO: WORKING WITHIN THE LEGAL FRAMEWORK

4. Basic insurance rate setting is governed by a unique legal framework, key elements of which were addressed in the Opening Statement delivered by legal counsel for ICBC.[6] ICBC will not repeat those submissions here. Two additional points do bear noting:

- First, *Special Direction IC2* was amended on February 18, 2014 (after the hearing) to extend the filing date for the next application from May 31 to August 31, 2014.[7] This results in PY 2013 changing from a nine month policy year to a 12 month policy year.

- Second, the *2011 Government Directive* still requires ICBC, and hence the Commission, to use for rate setting purposes the forecast year-end 2013 MCT as that forecast existed at the end of Q2 2013.[8]

5. There were a number of IRs and submissions filed in this proceeding that are, in essence, challenging the merits of the legislative framework itself. The letter of comment filed by Mr. McCandless[9] (on which ICBC was asked to comment in a number of Commission IRs) and the Evidence of Mr. Landale[10] are good examples of this. The Commission addressed this issue in the Reasons for Decision accompanying procedural Order G-193-13, stating:

> The Commission Panel reminds Interveners that all matters raised must be within the Commission's jurisdiction and Basic Insurance and have rate implications on this Revenue Requirements Proceeding. The Commission Panel also reminds Interveners that the Commission must follow Special Direction IC2 including any Government directives.[11]

In 2012, in the context of the Automobile Insurance Committee of the Canadian Bar Association - BC Branch (AIC) advocating a capital transfer from Optional insurance, the Commission took a

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[6] Exhibit B-14, Package of Relevant Legislation and Decisions; T2: 89, l.17 to 112, l.2.

[7] OIC 056, February 18, 2014.

[8] Exhibit B-25, OIC 560, November 30, 2011 (2011 Government Directive). This requirement is now also stipulated in *Special Direction IC2* for 2014 and beyond.

[9] Exhibit E-9. ICBC addressed Mr. McCandless' position relating to Saskatchewan General Insurance and Manitoba Public Insurance, for example, in the responses to 2013.1 RR BCUC.69.1 to 2013.1 RR BCUC.69.6.

[10] Exhibit C1-9.

[11] Order G-193-13, Reasons for Decision, p.4.

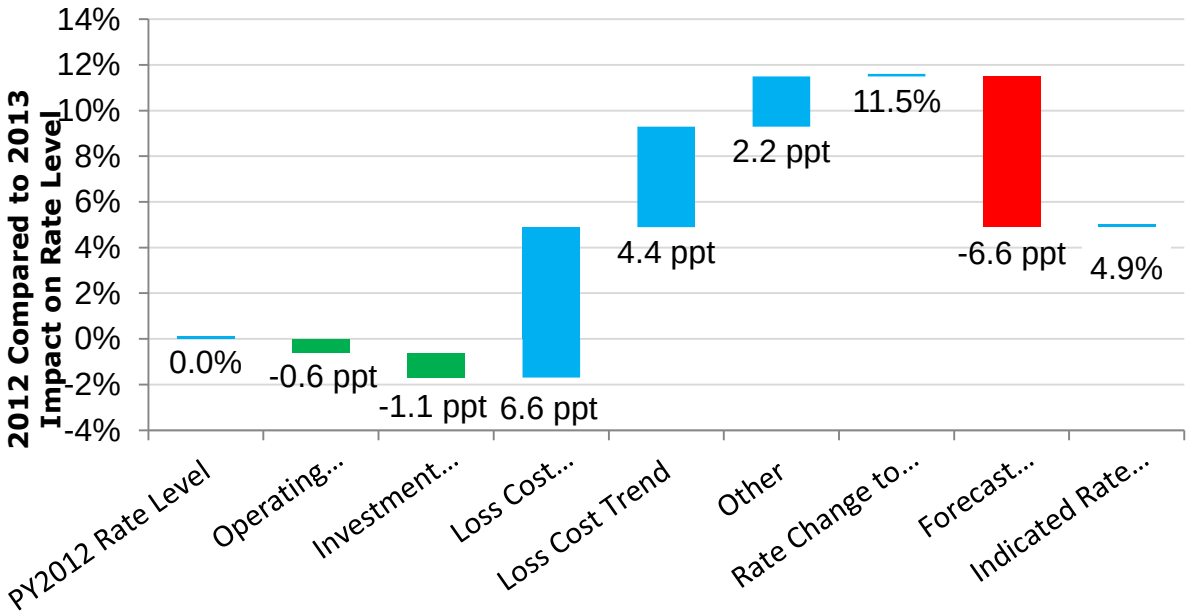
similar approach, stating: "Matters of public policy should be directed elsewhere."[12] ICBC submits that the Commission should continue to give effect to the legislative framework and not entertain the intervener submissions that stray beyond the Commission's jurisdiction.

[12] 2012 RRA Decision, p.44

PART THREE: EVIDENCE SUPPORTING ACTUARIAL RATE INDICATION

A. INTRODUCTION

7. In this Part, ICBC addresses the key components of the rate indication. They are summarized in the following figure:



The following points, each of which is explained in this Part, support the proposed rate increase of 4.9%:

- First, ICBC's actuaries have determined the rate indication in accordance with accepted actuarial practice in Canada, as is required by *Special Direction IC2*;

- Second, the loss cost forecast variance, which is driven by a flattening of the frequency trend after many years of steady decline, does not impact the PY 2013 rate indication because it has been excluded;

- Third, the loss trend to PY 2013 is based on sound actuarial modelling that gives appropriate recognition to the operational changes occurring at ICBC as well as the claims initiatives that are currently underway;

- Fourth, ICBC's significant initiatives to reduce operating expenses have been a success and are having a favourable impact on the rate indication;

- Fifth, ICBC's approach for forecasting investment income, which has been affirmed by the Commission on two previous occasions and incorporates the recent determinations in the *Generic Cost of Capital Stage 1* Decision[13], remains appropriate;

- Sixth, the inclusion of a capital maintenance provision is dictated by the *2010 Government Directive* and *2011 Government Directive*; [14] and

- Seventh, ICBC's forecast of the average premium trend is appropriate.

B. EMPLOYING ACCEPTED ACTUARIAL PRACTICE

8. *Special Direction IC2* requires the Commission to fix Basic insurance rates based on accepted actuarial practice.[15] Accepted actuarial practice in Canada includes adherence to the *Standards of Practice* of the Canadian Institute of Actuaries, as well as the *Statement of Principles Regarding Property and Casualty Loss and Loss Adjustment Expense Reserves* and the *Statement of Principles Regarding Property and Casualty Insurance Ratemaking* of the Casualty Actuarial Society.[16] Ms. Minogue, the Filing Actuary, and Mr. Weiland, a Reviewing Actuary[17], have certified that the rate indication of 4.9% accords with accepted actuarial practice in Canada.[18] There are three important components of accepted actuarial practice for the purposes of this Application, to which the Commission must have regard:

- First, Basic insurance rates should cover the costs of providing Basic insurance, subject to legislation;

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[13] May 10, 2013 Decision on the Commission's Generic Cost of Capital Proceeding (Stage 1).

[14] Exhibit B-25.

[15] *Special Direction IC2*, s.3(1)(c). The Commission has recognized this obligation in past decisions: see, for instance, the 2006 RRA Decision, included in Exhibit B-14.

[16] Chapter 3, para.26. At the hearing, Mr. Weiland expanded on the definition of accepted actuarial practice: T2: 124, ll.1-25.

[17] Mr. Weiland's role as "Reviewing Actuary" in the context of government reporting by ICBC is outlined in the *Insurance Corporation Act*, and he is fulfilling a similar function in this rate-setting context.

[18] Chapter 3, paras. 104-107.

- Second, the rate indication should be prepared based on information that is reasonable both on its own and appropriate in aggregate; and

- Third, the estimate of claims costs must be an unbiased best estimate based on all of the information available to the actuary at the time the estimate is prepared.

(a) Basic Rates Should Cover Costs, Subject to Legislation

9. The application of accepted actuarial practice in the context of this Application requires that PY 2013 Basic insurance rates reflect the costs of providing Basic insurance, subject to applicable laws.[19] The requirement in *Special Direction IC2* to fix rates according to accepted actuarial practice thus precludes the Commission from setting rates below cost except to the extent permitted by legislation.

10. The application of accepted actuarial practice means that Basic rates must increase in PY 2013. Ms. Minogue explained that Basic insurance is an inflationary product. Basic insurance costs have been increasing year-over-year for many years. They will continue to increase over time (absent some legislative intervention), despite ICBC's best efforts:[20]

> So we can really tighten down the operating expenses all the more, but it does have limited impact on the overall rate. That overriding driver of costs is the bodily injury claims trends.
>
> And the factors driving those costs are things that have a lot of upward inflationary force on, and again I have to emphasize the medical cost inflation, increased utilization, medical technology, increased representation and so on. There's a number of factors that are very hard to mitigate, and even to consider reversing them is even more a big challenge. Of course we would love to and we're looking for ways to control our claims costs, and our claims division is very proactive about looking at various alternatives in how to do that. But that's a challenge and I would suggest that to actually reverse some of these cost trends is something that is not easy to do, and unlikely.

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[19] Chapter 3, paras. 1 and 2.

[20] T3: 399, ll.5-23. See also: T3: 386, ll.9-25; T3: 396, ll.6-7.

Mr. Weiland confirmed that the inflation that ICBC has long been experiencing is "generally true in every Canadian jurisdiction for automobile insurance, that costs go up from year to year. And absent some kind of legislative intervention, they're going to continue to go up."[21] As such, ICBC's initiatives to manage claims costs and operating expenses are really aimed at reducing the upward trend in the cost of providing Basic insurance to the extent reasonably possible.

11. In the current circumstances, the only mandated exclusion from the rate increase that would be required to cover costs is the exclusion of the loss cost forecast variance. *Special Direction IC2* provides for the exclusion of the full loss cost forecast variance in PY 2013. The term "loss cost forecast variance" is defined. It is, in essence, the portion of the PY 2013 costs that reflects the difference between the loss cost forecast undertaken for PY 2012 and how the loss costs had emerged at the time of determining the new rate indication. This year, it is the largest single element of the rate indication required to cover costs. The effect of this legislated exclusion is to bring the rate change from 11.5% down to 4.9%.

12. The exclusion of the loss cost forecast variance does not reduce the underlying cost of providing Basic insurance. The exclusion means, in effect, that the rate increase that ICBC is requesting is well below what is actually required to cover the true expected costs of providing Basic insurance in PY 2013. Basic capital is used to cover the rate deficiency, which is the intent of rate smoothing. The rate deficiency will result in Basic capital declining by approximately 13 percentage points of MCT in 2013 (using the rule of thumb of 1% of indication approximating 2 percentage points of MCT). The rate deficiency will carry over into the next year and will continue to deplete capital each year until it is fully reflected in the rate indication as part of the new rate smoothing framework.

(b) Reasonable Assumptions, Both Individually and in Aggregate

13. Accepted actuarial practice in Canada requires that assumptions used in the rate indication be independently reasonable, and appropriate in aggregate. One way in which ICBC

[21] T3: 398, ll.6-10.

ensures that assumptions used are appropriate in aggregate is by performing the rate indication analysis at a single point in time, considering all information together. ICBC submits that the rate indication analysis included in the Application should be the basis of the Commission's determination. At a minimum, updated information must not be considered piecemeal.

14. Changes to assumptions in a rate indication analysis to reflect new information, though the changes might be reasonable on their own, could lead to internal inconsistency in the actuarial rate level analysis. A rate indication prepared on that basis would not be consistent with accepted actuarial practice. ICBC explained:

> Where individual assumptions are altered for the purpose of testing the sensitivity of the Basic insurance rate indication, this does not necessarily result in an updated rate indication that accords with accepted actuarial practice. Section 1720 of the Standards of Practice of the Canadian Institute of Actuaries requires that an actuary select assumptions that are independently reasonable, and appropriate in the aggregate. Alternative assumptions may be selected for sensitivity testing, as has been done in Chapter 3, Figure 3.16 and in the response to information request 2013.2 RR BCUC 160.1.1 and other information requests from the Commission and Interveners. In performing the sensitivity tests on individual assumptions, other assumptions are held constant, regardless of whether they are reasonable in combination with the newly altered assumption.
>
> Some alternative assumptions for which Basic insurance rate sensitivities have been provided are relatively independent from other assumptions in the actuarial rate level analysis. For example changes in assumptions relating to the level of Basic equity. However, other elements are not independent. For example, a change in the assumption used to select the bodily injury claim frequency trend might create an inconsistency unless an adjustment were also made to the accident benefits frequency trend to reflect the corresponding assumption. As another example, a change in any assumption to reflect more recent information could give rise to a temporal inconsistency, if information relevant to other factors had also emerged since the time of the Application.[22]

The effect of this principle is that each time new information is considered, ICBC's actuaries must undertake a full evaluation of the rate indication.

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[22] 2013.2 RR BCUC.159.2.

15. During the hearing, the Commission Panel requested that ICBC file updated information relating to components of the rate indication. It tasked ICBC with exploring how the Panel might consider that information given that the information will remain strictly confidential until it is tabled in the Legislature at the end of May.[23] ICBC will be filing with the Commission on a confidential basis a sensitivity analysis based on (a) incorporating information from the unaudited 2013 financial results into the Basic rate indication and (b) based on a 12-month policy year in light of the recent change in the next filing date specified by *Special Direction IC2*.[24] ICBC understands the Commission's desire to obtain the updated information given that its PY 2013 decision will form the initial starting point for the rate smoothing framework. ICBC submits that, given the confidential nature of the information, the Commission should limit its use of the information to confirming the reasonableness of the original rate indication. The updated numbers should provide the Commission Panel with the desired comfort in that regard.

16. ICBC submits, however, that it would be very inefficient to "chase data" in this manner in future years. Ms. Prior articulated four reasons why, in future applications, the Commission should be assessing the information filed in the Application:[25]

- First, updating the rate indication part way through a process is no small task,[26] since the actuaries must essentially re-do the rate indication. Ms. Prior characterized it as "really getting us to kind of do two filings for every round of filing that we're putting in. And I think we just ask that to be considered."[27]

- Second, an updated estimate of claims costs - by far the largest component of ICBC's costs - is still going to be an estimate.[28] As Ms. Prior advised, the reality is that if ICBC "were to look at all of the assumptions and redo them all, I'm pretty

[23] T7: 1169, l.9 to 1171, l.18.
[24] 2013 RR BCUC.UT.14C; OIC 056, February 18, 2014.
[25] T6: 856, l.17 to 859, l.16.
[26] It could take two to six weeks: 2013.2 RR BCUC.159.2.
[27] T6: 859, ll.14-16.
[28] T6: 860, ll.15-22.

sure that some would be up favourably and some would be down."[29] For instance, updating the new money rate (other things equal) has the effect of *increasing* the rate indication from 4.9% to 5.4%.[30]

- Third, unlike a public utility, ICBC's Basic insurance business is a closed system; any variances affect capital and are ultimately accounted for in future rates.

- Fourth, with annual rate filings now mandated by August 31 each year, new information will quickly be reflected in the upcoming proceeding. The work on the next filing is already underway.[31]

ICBC submits that the Commission should acknowledge the validity of these concerns in its Decision and underscore the exceptional circumstances that prompted its requests in this proceeding.

(c) Unbiased Best Estimates Based on Pertinent Information

17. Accepted actuarial practice also requires that the estimate of costs must be an unbiased "best estimate" (a term with a specific technical meaning to actuaries) based on information available at the time the estimate is made.[32] Mr. Weiland explained: "We're required to make a best estimate with no bias. Not conservative, not unconservative, but as nearly as we can to make it straight, straight down the middle."[33] Given the requirement to achieve best estimates under accepted actuarial practice in Canada, ICBC's estimates do not contain a contingency.[34]

18. When forecasting, there will be a range of professional judgments possible within accepted actuarial practice. However, Mr. Weiland explained that there should be "a

[29] T6: 861, ll.6-10.
[30] T7: 1111, ll.6-18.
[31] T6, 861, ll.16-18.
[32] Chapter 3, paras.1 and 2.
[33] T4: 598, ll.21-24.
[34] T4: 596, ll.1-6.

fairly narrow range" when actuaries have availed themselves of all of the relevant data.[35] As described in later sections of this Submission, there are a significant number of factors that are influencing claims costs at present. ICBC's actuaries have carefully considered all of those factors, both favourable and unfavourable, in selecting appropriate models and in arriving at a best estimate. Some commonly used models are not appropriate at present, and using them would not be consistent with accepted actuarial practice, because they would fail to account properly for changes in the underlying data and influential factors.[36]

C. THE LOSS COST FORECAST VARIANCE

19. This section addresses the loss cost forecast variance, the entirety of which has been excluded from the rate indication by virtue of *Special Direction IC2*. The loss cost forecast variance is the portion of the PY 2013 costs that reflects the difference between the loss cost forecast undertaken for PY 2012 and how the loss costs had emerged at the time of determining the new rate indication. At the hearing, most of the discussion on the loss cost forecast variance centred on why the data has emerged less favourably than had been expected at the time of the last filing, and how ICBC has accounted for it. On this topic, ICBC's evidence demonstrates the following points:

- First, ICBC has adopted a balanced approach that accounts for information regarding the causes of the long-term pre-recession downward trend, and the likely causes of the current flattening; and
- Second, ICBC's conclusion that smartphone use contributed to the flattening of the BI frequency trend is a reasonable inference from known information.

(a) Forecast of BI Frequency Informed by Available Information

20. In essence, the last filing had been based on a continuation of the downward BI frequency trend, which was reasonable in light of the information available at that time. The BI claims costs then emerged more unfavourably than anticipated, which is reflected in a flattened

[35] T4: 602, ll.13-18; T4: 595, ll.2-20.
[36] T4: 610, ll.3-16.

BI frequency trend. The emergence of a flattening BI frequency trend since the last filing is reflected in the Application, Figure 3.5, which is also included on slide 15 of Ms. Minogue's opening presentation.

21. ICBC's forecast of BI frequency, in particular the assumption that BI frequency will resume a downward trend at half the pre-recession rate beginning in 2014, is a balanced approach that accounts for information regarding the causes of the long-term pre-recession downward trend, and the likely causes of the current flattening.[37] The relevant information includes:

- The long-term, pre-recession downward BI frequency trend rate ranged from 3% to 4%. The causes of the downward trend are well-understood. ICBC explained that the long-term steady decline in BI frequency has been the result of the three favourable influences: safer vehicles, safer roads, and a growing proportion of drivers entering their safest driving years.[38] The original forces that have long been contributing to reduced frequency are still present, although no longer to the same degree.

- On the heels of the recession the formerly downward trend in BI frequency has flattened.[39] While there is some uncertainty around the causes of the flattening, it is significant that the marked departure from the pre-recession trend has occurred concurrently with the following three significant events: (1) the mass adoption of smartphones,[40] (2) a sustained drop in the proportion of new cars on the road[41], and (3) an abrupt end to the growth in the number of vehicles per

[37] Chapter 3, para.37. Mr. Loach confirmed at the hearing that frequency "…continues to follow the forecast that we had expected, which is for it to be essentially flat through 2013 and starting to trend down thereafter which is the assumptions that we have used in our forecast." T2: 280, ll.10-15.

[38] T4: 568, l.16 to 569, l.21.

[39] Chapter 3, para.32 and 33; T3: 485, l.16 to 486, l.10; T3: 311, ll.8-22.

[40] Chapter 3, para.34; 2013.1 RR CDI.4.1.

[41] 2013.1 RR BCUC.16.1; 2013.1 RR BCUC.16.2; ICBC uses its own data, which captures every insured vehicle in BC. Its figures should therefore be preferred to the auto industry news releases trumpeting strong vehicle sales. T4: 583, ll.22-23.

household.[42] The impact of these three new upward forces is still present; however, these appear to be (to use Mr. Loach's word) "softening".[43]

- There are also new favourable influences such as young people waiting longer to obtain their drivers' licences, a growing awareness of the dangers of texting while driving and corresponding enforcement initiatives, and a new generation of highly effective crash avoidance technologies.[44]

Taken together, these facts suggest a trend between the pre-recession long-term downward trend and a flattened trend. ICBC's best estimate, which falls midway between the two extremes, "strikes a balance between the favourable influences which contributed to the long-term pre-recession downward trend line and the offsetting factors".[45]

22. While other outcomes are possible, the range of assumptions that are consistent with accepted actuarial practice is limited. An assumption more favourable than the pre-recession trend would "be relatively speculative and therefore would most likely not be consistent with accepted actuarial practice."[46] Ms. Minogue, Mr. Loach and Mr. Weiland were also united in the view that assuming full resumption of the pre-recession downward trend "may contain bias".[47] This assessment was based on their knowledge of the factors "currently dampening" the favourable influences that yielded the long-term pre-recession trend.[48] Mr. Weiland explained, for instance:[49]

> Now, in the context of accepted actuarial practice, the actuary's job is to make a best estimate, and that best estimate needs to account for a number of things, including the past experience but also all of the circumstances in which the assumption is being struck. So all of the items that Mr. Loach has been discussing that would affect frequency, like number of vehicles per household and so on, number of new vehicles, all of those sorts of things need to be

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[42] Chapter 3, para.36; 2013.1 RR BCUC.17.1; T4: 517, l.4 to 518, l.7.

[43] T2: 281, ll.1-23.

[44] 2013.1 RR BCUC.24.1.3.

[45] 2013.1 RR BCUC.24.1.3. See also: 2013.2 RR BCUC.164.2.

[46] 2013.2 RR BCUC.164.1.

[47] 2013.2 RR BCUC.164.3

[48] 2013.2 RR BCUC.164.3.

[49] T4: 591, ll.3-20.

> considered when one is deciding whether or not in fact your forecast is a best estimate.
>
> And ICBC has done a considerable amount of work investigating the various factors that are affecting frequency, and that is why, after taking all this into account, we feel that the forecast that's in the filing is a best estimate and we believe does not contain a meaningful amount of bias.

23. Mr. Loach and Mr. Weiland thus confirmed that using a model to determine BI frequency that is based on simple extrapolation from the pre-recession trend (i.e., a 12-year exponential model, as was used in the last revenue requirements application) would no longer be reasonable given the evidence of other forces at work.[50] At the hearing, Mr. Loach walked through the logic behind the decision not to use the 12-year exponential model.[51]

24. Updated BI frequency numbers for accident year 2013 show an improvement of 0.01 from the number used in the actuarial analysis for the Application.[52] Ms. Minogue explained that the extent of the improvement shown is being influenced by very dry weather in 2013 that is not expected to continue.[53] The issue is moot from a rate setting perspective because the BI frequency numbers for accident year 2013 primarily influence the loss cost forecast variance. As that component of the indication is already excluded from the rate indication, the proposed 4.9% rate increase would not change even if the updated number were to be used.[54]

25. Adopting the most optimistic assumption that is within the acceptable range increases the prospects of a larger loss cost forecast variance next year, which must be accounted for in future rate filings.

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[50] T4: 608, l.5 to 609, l.15.

[51] T4: 610, l.17 to 611, l.25.

[52] The 0.01 is based on updated data: T4: 578, ll.8-22.

[53] T4: 569, l.22 to 570, l.9.

[54] T4: 578, ll.8-22; T4: 580, l.20 to 581, l.20.

(b) Evidence that Smartphone Use is Influencing Frequency Trend

26. There was discussion in IRs and at the hearing about the basis for ICBC's assessment that smartphone use is contributing to the flattening of BI frequency. The response to 2013.1 RR CDI.4.1 summarizes how the actuaries' judgment has been informed by three pieces of information:

- First, smartphone penetration has been increasing, reaching two-thirds of the population by 2012;
- Second, using a smartphone while driving significantly increase the risk of having a crash; and
- Third, over one-third of drivers in recent studies are admitting to using smartphones while driving.

Mr. Loach reiterated these points at the hearing.[55] Mr. Loach also confirmed that, while data linking smartphone use directly to crashes is not available, there is ample evidence from police statistics to suggest that distracted driving continues to make a significant contribution to crashes on BC roads after the ban.[56]

D. LOSS TREND TO PY 2013

27. The loss trend to PY 2013 has an impact of +4.4 percentage points on the rate indication, making it the largest component of the proposed net rate increase. It is primarily driven by the BI severity trend rate of about 6% per annum, with the other coverages moderating the effect. The loss trend component of the proposed rate increase is larger than in past applications, in part, because the trend reflects a period of 19.5 months, rather than the standard 12 month period between rate filings. When the loss trend for 19.5 months is converted to an annual percent change, it is 2.8%. The evidence demonstrates:

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[55] T3: 462, l.25 to 464, l.20.

[56] 2013.1 RR BCUC.15.3; T3: 455, ll.6-18.

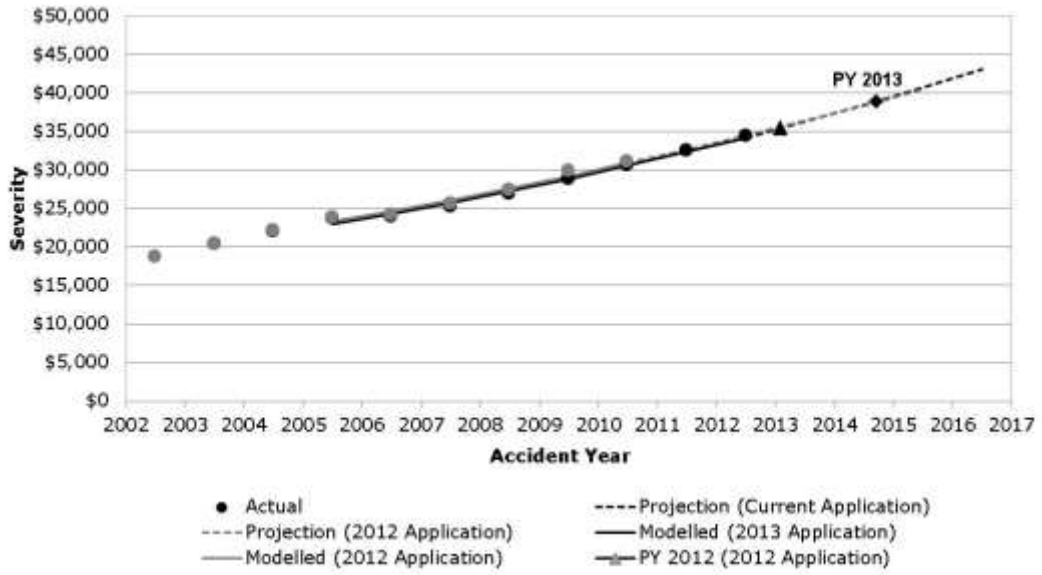
- First, BI loss costs account for the vast majority of Basic loss costs, and BI severity is the main contributor to the loss cost trend component of the required rate increase[57];

- Second, ICBC's actuaries have employed appropriate models and methods that account for external influences, operational changes, and new initiatives to manage rising claims costs; and

- Third, ICBC has made appropriate prospective adjustments to account for expected net savings from four events that have an incremental effect on future claims costs beyond what is reflected through the loss trend models.[58]

(a) Loss Trend Driven by Increasing BI Severity

28. BI loss costs account for the vast majority of Basic loss costs, and BI severity is the main contributor to the loss cost trend component of the required rate increase. BI severity has been increasing steadily over time at a rate of 6% per year. A figure below depicts the BI severity trend line.



[57] Chapter 3, Figure 3.12.

[58] Chapter 3, para.17.

29. The inflation on BI claims costs are driven by factors such as medical cost inflation, increased utilization, cost of medical technology, and increased legal representation.[59] ICBC estimates the sensitivity of a one percentage point increase in the legal representation rate to be about 1.5 percentage points increase in the BI severity trend rate. As discussed later, ICBC has recently implemented claims initiatives aimed at addressing factors that can lead to increased representation, and to help moderate claims costs.[60] Without these efforts, the BI severity would be at a higher trend rate such as 8%, which would increase the loss cost trend component of the required rate increase.[61]

(b) Appropriate Modelling to Yield Best Estimates of BI Severity (Historical View)

30. The actuaries use methods that are consistent with accepted actuarial practice in Canada to develop estimates of incurred claims costs for historical years. In producing the estimates, the actuaries have brought to bear their knowledge of ICBC's claims operations and other relevant factors.[62] The incurred claims costs for historical years form the basis for the loss trend analysis (subject of section (c) below) which addresses the growth in claims costs from their current level to the level of policy year 2013.

31. An unbiased best estimate of BI severity accounts for relevant information. ICBC's actuaries have employed appropriate models and methods in estimating BI claims costs that account for external influences, operational changes, and new initiatives to manage rising claims costs. As explained below, the actuaries for some years have adjusted or replaced two actuarial methods that ICBC has used in the past (the incurred development method and the paid development method). In the current context, the rote application of the two methods would not yield a best estimate that is consistent with accepted actuarial practice.[63]

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[59] T3: 399, ll.5-23. See also T3: 386, ll.9-25; 2013.1 RR BCUC.7.1 and 2013.1 RR BCUC.7.2

[60] 2013.1 RR BCUC.7.1 and 2013.1 RR BCUC.7.2.

[61] 2013.1 RR BCUC.6.3.

[62] Chapter 3, para. 79.

[63] Chapter 3, Exhibit C.0.5, paragraphs 12-17.

Adjustments Required to Standard Incurred Development Method

32. ICBC's actuaries have had to adjust the way that they apply the standard incurred development method to reflect operational changes within the Claims Division.

33. The standard incurred development method for estimating BI incurred loss relies on consistency in the level of case reserves being set by adjusters. A case reserve is the amount that is determined by an adjuster to provide for the cost of a particular claim. The adjuster revises the reserve (most often upwards) over the course of handling the file to reflect new information as it becomes available.[64] The amount by which reserves are revised over time (referred to as "development" on case reserves), in combination with the amount of payments actually made, is the focus of this method.[65] The actuaries apply to the amount of payments and case reserves a "loss development factor". It is vital to the use of the standard incurred development method that case reserves are being set on a consistent basis over time. When that is not the case, as at present, actuaries must make adjustments to the loss development factor, or use other methods.

34. At present, using the standard incurred development method is problematic because there have been operational changes that affect (a) how the adjusters are setting case reserves and (b) the mix of open claims on which reserves have been set:

- ***Change in how adjusters are setting case reserves***: The setting of case reserves is not an exact science. It is subject to some degree to the experience level and knowledge of the adjuster and manager handling the claim file. Before the increased segmentation of claims handling through the reorganization of the Claims Division, adjusters would see a larger variety of claims in their book of business and case reserves would typically and implicitly build in a margin for growth in the costs of a claim. The move to greater claim segmentation through implementation of the functional model in 2011 and the Claims Hierarchy in 2013 resulted in adjusters seeing greater consistency in files. It has improved

[64] 2013.1 RR BCUC.43.1-2.1.

[65] T4: 623, l.7 to 624, l.9.

the adjusters' ability to set more consistent reserves using refined assessments based on the information known at that time, which do not necessarily incorporate a margin to ensure adequacy (ICBC refers to this as setting more "accurate" reserves).[66] The timing of the operational changes is reflected in the average reserves, as shown in Figure 1 in 2013.2 RR BCUC 168.1.[67] The critical point is that setting more refined (and on average lower) case reserves, means that there is greater upward development on average.[68] Put another way, the final outcome of claims on average will not decrease in proportion to the reduction in average case reserves. The actuaries account for this higher expected development in their selection of loss development factors.

- ***Complex represented cases now form a larger proportion of cases:*** A by-product of the operational changes that involved the transfer of large numbers of files among adjusters to allow for segmentation is a temporary slowdown in the settlement of BI claims. It is reasonable to expect that there will be greater case reserve development as compared to the period before the changes because the slowdown in the settlement of BI claims, when combined with the acceleration of the representation rate, has resulted in a much higher number of open BI claims that are represented.[69] The more complex represented BI claims are also likely to experience higher claims costs on average, which translates into greater upward development on case reserve amounts.

35. ICBC summarized the issues associated with the operational changes as follows:[70]

> The development that has thus far occurred for accident year 2008 and subsequent has been lower than expected, particularly in the latest two calendar years (see response to information request 2013.1 RR BCUC.50.2). It is due to a combination of operational factors that have reduced reserve levels on newly

[66] 2013.2 RR BCUC.174.1.

[67] 2013.2 RR BCUC.169.2; 2013.2 RR BCUC.171.1; 2013.2 RR BCUC.172.2; 2013.2 RR BCUC.172.4.

[68] 2013.2 RR BCUC.169.1.

[69] 2013.2 RR BCUC.168.1.1.

[70] 2013.2 RR BCUC.168.1.1. See also: T4: 631, ll.10-20.

> reported claims and impacted the adjusting and settlement of claims, especially represented claims. All of this has combined to significantly reduce recent case reserve levels, as well as paid loss amounts, relative to previous levels but has not had a similar impact on ultimate cost levels; meaning that future development is anticipated to be greater.
>
> One impact of the operational changes is a slowdown in the settlement of bodily injury (BI) claims, which combined with the acceleration in the rate at which claims are becoming represented, has resulted in a much higher number of open BI claims that are represented. A represented BI claim is more complex and generally more costly to resolve than a like injury claim that is not represented.
>
> Consequently, it is reasonable to assume that there will be greater case reserve development and paid development in the future as compared to the period before these changes.

36. In Mr. Weiland's words, without making adjustments for the operational changes "given the nature of those changes, you'd be expecting that that [the standard incurred development method] would produce an estimate that would be too low."[71]

37. Some Commission IRs explored whether there could be alternative explanations for the decline in reserves, namely whether there has been a change in the mix of claims towards smaller claims that would support a lower severity trend.[72] The evidence does not support that inference. The actuarial analysis that supports the expectation of higher development in the future are further explained in the following responses:

- The response to 2013.1 RR BCUC.43.6.5 (confidential) demonstrates that case reserves have become less adequate (i.e., more refined, less margin added) in more recent years as compared to 2007 and prior.
- The response to 2013.1 RR BCUC 43.4 (confidential) explains why on average there is now more upward development on case reserve amounts, not less.

[71] T4: 624, l.10 to 625, l.22.

[72] 2013.1 RR BCUC.43.7.2.

Paid Development Method Supplemented by Hindsight Outstanding Method

38. The paid development method, which ICBC has used in previous years, relies on consistent claim settlement rates from year to year to produce reasonable results.[73] ICBC has adopted a different method, the hindsight outstanding severity method, to address the deficiencies in the paid development model.[74] Ms. Minogue elaborated:[75]

> I'd like to point out that this is consistent with accepted actuarial practice. In fact not to do so would not be consistent with accepted actuarial practice. We did put a reference in the response to first round IRs 44.1 that speaks directly to when development techniques work and when they don't, and an authoritative source that's on the syllabus for all actuaries qualify, and it speaks to the leverage effect of these methods and without -- and that sometimes they are not -- they don't work appropriately, and that you need to make adjustments.
>
> So I have referred the Commission to that IR, but our methods of adjustment are actually expected within accepted actuarial practice.

39. The response to 2013.1 BCUC 43.7 describes how recent claims operational changes have resulted in a slowdown in the settlement of BI claims and shows that there is now a much higher number of open BI claims that are represented by legal counsel. ICBC submits that it has demonstrated the need to make use of the hindsight outstanding severity method.

(c) ICBC's Best Estimate of BI Severity (Future Years)

40. Based on the historical BI severities, ICBC's actuaries apply statistical modelling and consider relevant information regarding operational and external influences to forecast the future level of claims frequency and severity. ICBC's best estimate of BI severity is based on the assumption that claims initiatives will be able to fully offset the cost pressures associated with the recent acceleration in the representation rate. The assumption results in a continuation of the stable trend line at a rate of about 6%.[76] There is, however, greater uncertainty around the

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[73] T4: 632, ll.14-18.

[74] T4: 632, l.19 to 633, l.12.

[75] T4: 633, l.14 to 634, l.1.

[76] 2013.2 RR BCUC.160.1.

estimate of ultimate claims costs because of the operational and external changes that are occurring.[77]

41. Although ICBC's initiatives could ultimately be very successful, it is important to understand that "success" really means eliminating the recent acceleration in the rate and resume a steady upward trend that was, until recently, in place for many years. It would be unreasonable based on the information currently known to assume that the initiatives are capable of producing a constant (i.e. flat) legal representation rate that would produce a lower severity figure (4%) than it has been for many years (6%). There are other factors at play in driving the accelerated representation rate beyond just ICBC's claims handling processes. ICBC explained:

> ICBC believes that representation rates are driven by additional external factors beyond claims initiatives. Based on this belief as well as historical patterns in both legal representation and BI severity, this scenario [i.e., a flat legal representation rate] is quite optimistic, and does not represent an outcome that would be reasonable to expect based on the current information. Therefore, this scenario would most likely not be considered within accepted actuarial practice.[78]

42. Ms. Minogue expanded[79]:

> What happens if you don't apply those adjustments is that you are unduly optimistic and you're not taking into account the realities of the situation, and in a way, you know, while you are setting yourself up for a big shock later. That's why we have actuaries because they are trained in this, in watching, keeping their eye on the ball and making sure that the appropriate methods are applied to estimate ultimate claims costs.

43. ICBC's evidence was that it is also fundamental to the sustainability of the rate smoothing framework for loss cost forecasts to be unbiased (i.e. neither optimistic, nor pessimistic, and a best estimate of expected future claims costs per policy based on claims costs data available at the time the forecasts are made.)[80] ICBC's past experience demonstrates that,

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[77] T4: 634, ll.17-18.

[78] 2013.2 RR BCUC.160.2.

[79] T4: 647, ll.8-16.

[80] 2013.1 RR BCUC.65.2.

by employing appropriate estimating practices, it is reasonable to assume that there is an equal probability of there being favourable and unfavourable variances each year.[81] This is important:

> The assumption [that there is an equal probability of favourable and unfavourable LCFV each year] is important because, if the loss cost forecast were set optimistically year after year, the rate smoothing framework would be in a mode of using capital every year and not being able to re-build what has been used to smooth rates. This is clearly unsustainable and such a situation would ultimately end in capital falling below its regulatory minimum.[82]

As an illustration of how quickly optimistic rate setting can use up Basic capital, a "rule of thumb" is that a deficiency of one percentage point in rate change for one year equates to approximately two percentage points of MCT. A loss cost forecast variance of 6.6% next year followed by 5.5% variance the following year (all else equal) would reduce the MCT by over 20 percentage points.[83]

(d) ICBC Has Made Appropriate Prospective Adjustments

44. Accepted actuarial practice requires a best estimate of future costs, and this requires that prospective adjustments be based on appropriate evidence rather than based on intuition. ICBC has been conducting broad project scans with internal experts to identify candidates for prospective adjustments. Changes that are sufficiently large scale to contribute to a departure from general trends, however, are by their nature unusual occurrences. When they do occur, there are many differences in the type and availability of information required to produce credible estimates for the prospective adjustment process. Some changes will be relatively easy to quantify (e.g. sales tax changes), while others (e.g. major infrastructure changes) will be inherently more difficult to quantify.[84]

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[81] 2013.1 RR BCUC.65.2. ICBC's recent history of forecast variances is that there have been four loss cost forecast variances that are unfavourable and three that are favourable.

[82] 2013.1 RR BCUC.65.2.

[83] Chapter 4, p.4-12; 2013.1 RR BCUC.66.2.

[84] 2013.2 RR BCUC.162.1.

45. In the 2012 RRA Decision, the Commission agreed with ICBC "that prospective adjustments should be made based on sufficient data and the use of accepted actuarial practice" but expressed the following concern regarding the future assessment of major projects:[85]

> The Panel is concerned that ICBC's framework for assessment of large projects with significant potential may be inadequate to reflect prospective changes in a timely manner. That said, the Panel does recognise that cost effectiveness must be considered in cases where the rate impacts may be transitory due to ICBC's closed system.
>
> …
>
> The Panel is concerned that the combined effects of a lack of pre-planning to acquire useable data and the threshold of proof required by ICBC to meet its fourth criterion, Estimable Effects, may result in projects failing to pass the initial screening under criteria 2, Causal Relationship to Claims Savings.
>
> The Panel encourages ICBC to continue its development of an appropriate framework that responds to potential prospective adjustments in a pragmatic and timely manner. Co-ordination of data gathering capability with other agencies should be pursued as part of this initiative.

46. It will be apparent to the Commission from the section in the Application on prospective adjustments[86] that ICBC has formalized its assessment processes and is already devoting significant time and attention to identifying and assessing future events as candidates for prospective adjustment. ICBC understands the Commission's desire to enhance ICBC's ability to incorporate further prospective adjustments for major projects. Nevertheless, ICBC continues to believe that it is not in the best interest of Basic policyholders at this time to invest the significant additional resources that would be required to try to generate reliable estimates for such projects to meet the requirements of accepted actuarial practice for prospective adjustments. ICBC explained:

> It should be noted, however, that major infrastructure projects, such as the Port Mann Bridge project and Canada Line, may not be good candidates for prospective adjustment studies. As explained in 2012.2 RR BCUC.140.2, filed in

[85] 2012 RRA Decision, pp.27 and 28.

[86] Chapter 3, Exhibit E.0.

> the response to information request 2012.2 RR BCUC.140.1-2, estimation of claims impacts from these kinds of projects present particular challenges due to their indirect relationship to claims costs. In fact, as detailed in 2012.2 RR BCOAPO.26.1, there exist complex relationships between large infrastructure projects, claims frequencies and severities, and other factors such as traffic volume and density, roadway and intersection capacities, pedestrian and cyclist traffic volume, and vehicle speed. This complexity is compounded by the fact project sponsors, whose attentions are focused on their project requirements, are not necessarily inclined to participate in undertaking the complex studies to isolate, estimate and attribute with sufficient accuracy the impacts that such projects might be expected to have on ICBC's claims costs. Also, given that the benefit of including any particular prospective adjustment will eventually be captured in the trend, it is not clear that ICBC would be providing value to its customers by taking on the expense of time and resources required to establish appropriately accurate and credible estimates in such cases.[87]

47. ICBC's point really boils down to an issue of diminishing returns. ICBC could always spend more money and do more work when it comes to attempting to estimate the insurance impact of major infrastructure projects. However, there is no guarantee of success in developing credible estimates. It should not be assumed that the impact, once analysed, would always suggest a favourable adjustment (as a simple example, highway improvements are valuable for many reasons but may not reduce claims costs if they lead to increased speeding). In addition, once improvements are in place, any impact on claim occurrence would quickly be reflected in the loss trend. This is a circumstance where taking a pragmatic approach means that the "nice to have" should give way to these realities.

E. REDUCTIONS IN OPERATING EXPENSES HAVE FAVOURABLE IMPACT

48. This section addresses ICBC's steps to control operating expenses. Ms. Prior described in her opening presentation how in 2011, after a period of increasing staffing to move to a more customer focussed model,[88] ICBC decided to "peel back what we could" to mitigate rapidly rising claims costs and a significant rate increase.[89] As described in Chapter 7, the cost savings achieved since ICBC shifted focus are significant and have a favourable impact

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[87] 2013.2 RR BCUC.162.2.

[88] T5: 819, l.5 to 824, l.1.

[89] T5: 824, ll.2-9.

of -0.6 percentage points on the rate indication. ICBC addresses below specific issues identified in IRs and at the hearing and makes the following points:

- First, ICBC has taken appropriate steps to reduce the number of FTEs and improve efficiency;
- Second, ICBC's compensation program in place during 2013 was consistent with PSEC guidelines and has been improved for 2014; and
- Third, ICBC compares favourably to industry on key efficiency indicators.

At the end of this section, ICBC also addresses cost allocation, making the point that ICBC has complied with the Commission approved allocation methodology.

(a) Appropriate FTE Reductions Have Reduced Operating Expenses

49. Ms. Prior summarized in her opening statement some of the steps that ICBC has been taking to reduce operating expenses, a significant component of which is compensation. The steps included vacancy management (i.e., not automatically backfilling vacant positions), and a functional review that culminated in moving to a shared service model. Ms. Prior explained that an advantage of a shared service model is that "it brings your staffing a little bit tighter".[90]

50. There are a number of indications that ICBC's steps to rationalize the company have been a success. For instance:

- ICBC has met its commitment in response to the government review to reduce total management and confidential staffing to a level more consistent with 2008. This involved reducing the workforce by 260 positions without increasing contractors to do base work.[91]

[90] T5: 825, l.2 to 826, l.9

[91] 2013.2 RR BCUC.215.2; T5: 827, l.4 to 830, l.2; T5: 833, ll.6-24.

- The ratio of FTEs per 1000 policies, an indicator of efficiency, has improved by 10% over the period from 2009 to 2013.

- Span of control has been increased, meaning that managers are on average overseeing more staff.

51. Ms. Prior summed up ICBC's efforts to reduce FTEs and improve efficiency as follows:[92]

> So we think we've done a tremendous job in bringing those [FTE] numbers back down. We would have come down after the transformational program work. We were pushed by this review to bring things down a little bit earlier, so things are a little bit tight right now. I think my colleagues would agree, a little bit tight right now, but we are managing.

The objective evidence bears out Ms. Prior's assessment.

(b) ICBC's Compensation Program is Reasonable

52. The same rigour is being applied to compensation levels.

PSEC Approved and Based on Market Median

53. Bargaining Unit compensation levels are fixed by collective agreement, which was negotiated within the confines of the Public Sector Employers' Council's (PSEC) guidelines.

54. The Management and Confidential compensation program has similarly been developed with regard to PSEC guidelines. Within this framework, ICBC targets total compensation to deliver at the market median for similar positions within a pre-determined labour market comparator group approved by its Board of Directors and PSEC. ICBC uses an external consulting firm to conduct the total compensation review.[93] ICBC's management and executive compensation plan was recently revised to align with the government review

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[92] T5: 829, ll.8-14.

[93] 2013.2 RR BCUC.208.1-1.2.

recommendations. Changes were implemented effective January 2014.[94] Mr. Hale summarized:[95]

> There's a number of different measures that ICBC has undertaken in recent years to ensure compensation controls, the first of which is that there have been no base wage increases for fiscal years 2013 and nor will there be for 2014. 2015 is unknown at this point in time. There have been a number of controls put in place as of January 1st, 2014 with respect to compensation arising out of the government review and secondarily arising out of the Crown corporation executive compensation policy that went into effect in August of 2012.

Incentive Pay Accords with Industry and Aligns With Corporate Objectives

55. At the hearing, Mr. Hale described how incentive pay is determined both for Bargaining Unit and Management and Confidential employees.[96] He addressed the common misunderstandings around the nature and objective of incentive pay:[97]

> Yeah, I just think I would comment that through media, other commentary, intervener reports, there's a lot of misunderstanding around bonuses, characterization of these payments. Incentive payments drive individual accountability toward specific goals. And if those goals aren't achieved, then that component of that payment is withheld. There is no component of payment when that isn't achieved. And in fact in the gain sharing, there's been years recently where about half of the payment has been withheld because the achievement was not reached. And so that's a real substantial difference in a potential component of an individual's pay in a given year, and so it's important to the Corporation to ensure that we are meeting our financial obligations, as well as other obligations in regard to our corporate mandate and that is one part of how we ensure achievement toward those financials, and the gain sharing program is one component of that.

56. Incentive pay remains an important tool for ICBC that brings value to policyholders. For example, ICBC's incentive pay is already aligned with the corporate priority on reducing claims costs by virtue of the corporate component being tied to the combined ratio, which includes a component related to claims costs. In addition, employees within the Claims Division have targets that are tied to claims cost management (or BI claims costs

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[94] 2013.2 RR BCUC.208.1.3.

[95] T5: 842, ll.16-26.

[96] T6: 905, l.8 to 910, l.8; T6: 912, l.5 to 914, l.7.

[97] T6: 909, l.16 to 910, l.8.

specifically for BI-focussed employees). Mr. Hale confirmed that ICBC is also looking to augment that focus by refining corporate-level incentive pay requirements to increase the focus on BI costs and severity.[98]

57. It is common for incentive pay programs to result in most employees getting incentive pay. The industry average is 97%. Mr. Hale added that looking at the public sector alone, "I think that you would find very similar data to ICBC, and in fact in my experience ICBC has quite a rigorous program of incentive pay, certainly increasing in rigour in the very recent past including changes that have been made as of 2014."[99]

(c) ICBC Compares Favourably to Industry on Expense Ratio

58. ICBC compares favourably to industry on the key metric of expense ratio. The expense ratio is the ratio of non-claims costs to insurance premiums earned, and is thus one measure of efficiency. The most recent comparative numbers are set out below (a lower number is better) and demonstrate that ICBC's results (both corporate and Basic) are significantly better than the results for the industry as a whole:[100]

Industry	ICBC Corporate	ICBC Basic
28.2%	21.1% (or 20% excluding TP and restructuring costs)	15.7%

(d) ICBC Has Complied With Approved Allocation Methodology

59. Allocation was initially addressed in 2005, but there have been several proceedings since that time that have revisited the allocators applicable to the majority of ICBC's operating expenses. Ms. Prior provided her assurance as CFO that ICBC has always sought to follow the approved methodology and allocators.[101] As corporate reorganizations have taken place, ICBC has tracked the movement of costs and has continued to apply the same approved allocators. Ms. Prior described the significant lengths to which ICBC is going to track

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[98] T6: 869, l.9 to 870, l.9.

[99] T6: 863, l.21 to 866, l.14.

[100] Exhibit B-13, Opening Presentation, slide 13; T5: 831, l.11 to 832, l.14.

[101] T6: 932, ll.20-25.

the costs; for instance, there is a person in the Finance Division who effectively works full-time manually tracking costs in a big binder of spreadsheets.[102]

60. At the hearing, counsel for IBC identified an error in the way that ICBC had applied one allocator to specific cost centres. In response, Ms. Prior and her staff (a) investigated the cause of the discrepancy (it was a good faith human error), and (b) vetted every other cost centre and allocator going back three years to 2010 to ensure that there were no more instances where the costs did not align with the approved methodology. Ms. Prior confirmed to the Commission Panel that, but for that single error identified by IBC, the allocations otherwise tracked the approved methodology.

61. The fact that the CFO herself, and others on her staff, reviewed the allocations, and that they identified no further errors, speaks volumes about ICBC's adherence to the approved methodology. It should provide the Commission with the necessary comfort that a review of the allocation methodology can be efficiently deferred until after corporate transformation is completed.[103] The pending response to UT 15C, which is the updated information requested by the Commission Panel, will also reflect the corrected allocator. The impact of the correction on the rate indication was so small as to be lost in the rounding.

F. FAVOURABLE IMPACT OF INVESTMENT INCOME

62. Investment income earned on new premiums collected and Basic equity is used to help reduce rates for policyholders. This year, ICBC's forecasted investment income has offset approximately 11% of the total cost of Basic insurance.[104] It is having a favourable impact on the rate indication of -1.1 percentage points.[105] The evidence demonstrates two points:

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[102] T7: 1087, l.21 to 1088, l.6.

[103] The response to 2013.2 RR BCUC.224.1-2 explains why it would be inefficient to address performance measures prior to the completion of the Transformation Program. Similar to the timing of a performance measures review, it makes sense to do allocation after the completion of the Transformation Program.

[104] T5: 814, ll.18-26.

[105] Chapter 2, para.18. Ms. Prior also provided an explanation for why the contribution due to investment income is increasing at T5: 815, l.12 to 816, l.18.

- First, it is appropriate and efficient to continue using the Commission-approved formulae, with updated inputs, for determining the forecasted investment income for the rate indication; and

- Second, ICBC continues to employ an efficient asset mix that balances risk and return.

(a) Commission-Approved Formulae Remain Appropriate and Efficient

63. The yield formulae employed in calculating the New Money Rate and the Yield on Basic Equity used in the actuarial analysis are, with two exceptions discussed below, the same formulae approved by the Commission in 2010 for use in revenue requirements applications.[106] In the 2012 RRA Decision, the Commission again commented favourably on the methodology: "The Panel therefore finds ICBC's evidence respecting its methodology of determining the impact of the New Money Rate and Yield on Basic Equity to be persuasive,…".[107] There is no reason to depart from that methodology in this proceeding.

64. The two changes to the methodology are best characterized as updates to reflect new information, and do not affect the logic of the formulae:

- The New Money Rate formula is in accordance with the new strategic asset mix that was expected to be in place by the end of 2013 (and is in place as expected).[108]

- The formulae have been updated to incorporate the new risk free rate and market equity risk premium determined by the Commission in its May 2013 *Generic Cost of Capital Stage 1 Decision*.[109] Using an increased market equity risk premium and the 3.8% risk-free rate is appropriate given the Commission's

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[106] April 2010 Decision on the Streamlined Regulatory Process.

[107] 2012 RRA Decision, p.31.

[108] In Exhibit B-1-1 ICBC indicated that it is not proposing to change the formula for the New Money Rate in the 2013 Revenue Requirement Application. However, ICBC does see the need to revise the formula once the transition process is further advanced as part of the next revenue requirement application.

[109] Chapter 5, paras. 9 and 10; 2013.2 RR BCUC.190.2 and 2013.2 RR BCUC.190.3.

recent determinations,[110] and the impact on the rate indication is favourable. In the absence of these changes, the rate indication would have been approximately 1 percentage point higher.[111]

(b) ICBC is Managing the Portfolio Appropriately

65. ICBC is responsible for managing its investment portfolio. ICBC employs and retains experts to manage its investment portfolio within the confines of a well-considered Statement of Investment Policy that gets reviewed regularly.[112] ICBC has a good track record. There are strong governance mechanisms in place.[113]

66. Mr. McCandless, in his letter of comment, maintains that "Since the Core Review, and particularly after the world financial crisis of 2009-10 ICBC management has adopted a policy of financial risk aversion."[114] He is incorrect. ICBC has assumed the same approximate level of investment risk since 2003, making only minor revisions to investment asset mix in response to market conditions[115]. ICBC's most recent revisions involve minor changes to the asset mix in an effort to reduce the volatility of its investment returns while maintaining the same approximate level of investment return.[116] ICBC observed that: "If ICBC was totally averse to risk it would invest its entire portfolio of assets in Government of Canada short-term bonds. Instead, ICBC has prudently incorporated corporate bonds, mortgages, equities, and real estate into its strategic asset mix in an effort to generate an added return over the risk-free portfolio return."[117]

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[110] 2013.1 RR BCUC.95.6; T7: 1172, l.4 to 1175, l.14.

[111] Chapter 5, para.21. ICBC's proposal to use of the 3.8% risk free rate alone has a 0.5% favourable impact: T7: 1177, l.9 to 1178, l.2.

[112] 2013.1 RR BCUC.102.2.

[113] Chapter 5, para.3.

[114] Exhibit E-9.

[115] 2013.1 RR BCUC.102.2.

[116] T7: 1120, l.9 to 1121, l.2.

[117] In Exhibit B-1-1 ICBC explained that the new asset mix included in the April 15, 2013 Statement of Investment Policy and Procedures includes a higher allocation to mortgages and real estate, a new allocation to high yield bonds and reduced allocations to equities and Canadian bonds. ICBC addressed specific questions on why it is not investing in higher risk sub "B" rated bonds in 2013.2 RR BCUC.4.3C.

67. Ultimately, it is up to ICBC to select the asset mix and manage the portfolio.[118] In any event, most private investors would be envious of the returns that Ms. Gould and her team have achieved based on the prudent risk profile of the portfolio. There is no justification for the Commission to entertain either investing advice from non-experts or speculation about whether returns could have been higher. The Commission should find that the forecast investment income is reasonable.

G. CAPITAL MAINTENANCE PROVISION

68. The Commission affirmed in its November 2010 Reasons for Decision that a provision for capital maintenance is a required cost element, as it is necessary to maintain capital levels in the face of inflationary pressures on costs and a growing policyholder base.[119] ICBC and the Commission have no discretion as to the inclusion of the capital maintenance provision in the PY 2013 rates. The 2013 Government Directive regarding Rate Smoothing requires ICBC to employ the current CMP in determining the rates for PY 2013. The existing Commission-approved CMP specifies how ICBC must calculate the capital maintenance provision.

H. CHANGE IN AVERAGE PREMIUM

69. The change in average premium adds +1.0 percentage points to the rate indication. The average premium is affected by shifts in the mix of business by rate class, territory and levels of discount (these factors all determine the premium an individual policyholder will pay). It is necessary for the rate indication to reflect the variances from the trend assumed in existing rates, and to estimate the expected change in premium from PY 2012 to PY 2013. The change in average premium is explained in the Application, Chapter 3, starting at paragraph 22. As in past years, it does not appear to be controversial based on the lack of

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[118] There are legislated parameters regarding asset mix, and ICBC has some flexibility within them: T7: 1118, l.15 to 1119, l.6.

[119] Factors such as growth in the number of policyholders, increases in claims costs and growth of investments cause the "capital required" (denominator of MCT ratio) to grow over time. Correspondingly, "capital available" (numerator of MCT ratio) must grow by the same percentage as the denominator in order to maintain the same MCT ratio. See also Chapter 4, para. 45.

IRs or questions on the topic. ICBC will address any intervener submissions on this point in Reply.

PART FOUR: CLAIMS COST MANAGEMENT

A. INTRODUCTION

70. In this Part, ICBC addresses the steps that it is taking to address rising claims costs. Ms. Minogue summed up ICBC's focus on claims cost management as follows:[120]

> I think our claims folks are making every effort to get things under control and in fact it's a corporate priority to get the bodily injury claims costs under control and our folks in road safety are working very hard around distracted driving and doing what we can. I mean, we are all rallying around this and I just can't emphasize enough. And it's really a team effort on the part of our Corporation. So yeah, we're going to try and do it.

The evidence supports the following findings, each of which is addressed below:

- First, ICBC's re-organization along functional lines, as well as its other efforts to segment claims, are consistent with industry best practices and are making the claims handling process more efficient and effective;
- Second, ICBC is taking appropriate steps to understand and respond to the accelerating legal representation rate;
- Third, ICBC's Road Safety initiatives, which primarily target crash frequency including crashes that result in bodily injury, continue to be effective and ICBC is increasing its focus on personal electronic device (PED) use while operating a vehicle; and
- ICBC is continually revising its anti-fraud strategies to use resources and technology more effectively, and should benefit in time from the data captured in the new systems.

The actuarial rate indication reflects ICBC's expectations that the claims cost management initiatives will collectively have a favourable impact on claims costs, reducing the rate indication from what it otherwise would be in the absence of these initiatives.

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[120] T3: 419, ll.12-20. See also: T3: 383, ll.11-25 and T3: 385, ll.6-13.

B. CLAIMS SEGMENTATION

71. ICBC's re-organization along functional lines, as well as its other efforts to segment claims, are consistent with industry best practices and are making the claims handling process more efficient and effective. ICBC expects there to be unfavourable transitional impacts, but that there will be longer-term benefits from the initiatives.

(a) Claims Segmentation/Functional Model Help to Control Claims Costs

72. Chapter 6 of the Application explains that claims segmentation is a cornerstone of ICBC's claims handling strategy. The functional model, which was implemented in 2011, is based on claims segmentation. It aligned claims within separate organizational units for injury and non-injury claims and, for BI claims, by whether a claim is represented or unrepresented. The Claims Job Hierarchy that was implemented in early 2013 supported the functional organizational model. It improved the alignment of appropriate staff and processes to the type of claim presented. Both of these initiatives are consistent with industry best practices[121] and facilitate more effective and efficient claims handling.

73. The alignment of operations, management, and employees based on claim type and complexity allows greater focus and responsibility for business results within each organizational unit, thereby improving overall management accountability. Classifying claims by type and complexity in order to better match each claim with appropriate claims handling models and adjuster and manager skill sets improves ICBC's ability to address claimants' needs, develop and deliver strategies appropriate to each organizational unit to further enhance claims handling and address current and emerging issues like the accelerating legal representation rate.[122]

74. Mr. Wilson summed up as follows:[123]

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[121] 2013.1 RR BCUC.103.2.

[122] Chapter 6, paras.25-27.

[123] T2: 213, l.6 to 215, l.9.

…I'd like to take this opportunity to refer to our evidence in Chapter 6, which was that our functional model as we call it, which is really just an organizational structure, to best manage our files was changed in late 2011. And the adjusters followed in 2013. So that we have four different levels of claims. We have unrepresented and then going on up to represented and higher complexity and catastrophic.

The idea being that we don't treat all customers the same, and we don't have one adjuster handling four or five different types of files. The whole foundation of this model, and it's a best practice across North America, is that you match the skills sets to the file and you provide the appropriate training and manager oversight.

So with our unrepresented customers, we talked about telephone claims. The telephone claims handling is an efficient way to ensure that the adjuster, whoever they are, throughout the province, with the right skill sets, can correspond with that customer immediately, not five or six days from now. That if they need to go to a therapist, they can get -- they can go to their physio or massage or chiropractor immediately, not without waiting to get into an office on their time.

And the adjuster has a manager who helps them when it's a higher-complexity case above their authority, or the manager frequently is used if there is an impasse. So it's a second set of eyes. If an adjuster and an unrepresented customer cannot agree on what a claim is worth, a manager is there to coach, or to help the adjuster resolve an impasse. Similar to the mediation analogy that Ms. Flewelling spoke to. That's the appropriate process, we believe, for a straightforward unrepresented claim. As the claims move up in complexity, up to our most complex claims, we add more manager support or committee.

Simply put, when you're making a decision on that big of a claim, it's better to have the right experts in the room, and it's better to have a couple of them.

And I took these few minutes to correct some of the statements of earlier, because I think it's being categorized as everybody's getting more process. In fact for the vast majority of our customers it's the exact opposite. There's less process. You can phone us 24 hours a day. You don't need to come into a claim centre. The adjuster has ample authority to settle most of the files within their range. They rarely go to a manager. And as the risk increases, I believe our oversight, and Ms. Minogue referred to this earlier about our dual role, the amount of oversight or protection of our policy holders' funds should be commensurate with their risk. And that's the foundation of our structure.

(b) Transitional Impacts

75. ICBC has accounted for the reasonable expectation that the significant structural changes at ICBC, accompanied by the transition away from legacy systems, are likely to have unfavourable transitional impacts.[124] It is intuitive to expect that these factors can, in turn, have an unfavourable impact on the legal representation rate at least in the short term. However, the evidence is clear that the changes must be undertaken.[125] ICBC is expecting an improvement in the rate of legal representation leading into 2015-2016 as the transition completes.[126]

C. MEASURES ADDRESSING ACCELERATING LEGAL REPRESENTATION RATE

76. The rate of legal representation among claimants has been increasing for many years. The rate has accelerated beginning in 2012. This is a significant driver of rising BI claims costs.[127] The evidence demonstrates that:

- First, legal representation affects BI claims costs in a variety of ways;
- Second, there are a wide variety of factors that can influence a person's decision to obtain legal representation, only some of which are capable of being influenced by ICBC;
- Third, ICBC is taking appropriate steps to understand and respond to the accelerating legal representation rate; and
- Fourth, AIC's suggestion that the new organization is more bureaucratic is misinformed.

ICBC's actuaries have accounted for the steps being taken to address the accelerating rate of legal representation. ICBC is using a BI severity trend line of 6%, whereas it would be 8% if ICBC were to have assumed that the accelerating representation rate would continue unabated.[128]

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[124] Chapter 3, Exhibit E.5.
[125] T5: 819, l.11 to 821, l.6.
[126] T5: 736, l.22 to 737, l.3.
[127] 2013.1 RR BCUC.154.4, Attachment A, pp. 6-7; Chapter 3, para. 46; 2013.1 RR BCUC.44.3.

(a) How Legal Representation Affects Claims Costs

77. ICBC's assessment of the merits of a particular claim would be the same regardless of whether the claimant is represented or unrepresented.[129] However, legal representation still affects the claims costs in a variety of ways. Represented claims cost more because, among other factors, legal costs are incurred, more expert reports are typically obtained, there is increased utilization of medical services, and it complicates the dealings between the parties.[130] ICBC elaborated:

> The increased cost of legal representation manifests in the increased legal process and expense associated with representation and litigation. There can be many reasons for this, including simple compliance requirements for the process, the introduction of multiple opposing experts, the length of time taken to set down discovery and trial dates to accommodate counsels' calendars, and other factors. ICBC believes the escalating trend is affected by how plaintiffs choose to litigate their case and which disbursements (expert reports) they incur. ICBC has seen an increase in the number of experts used by represented plaintiffs and increasing costs associated in using these experts.[131]

Ms. Minogue noted that it is a "well understood phenomenon" that for every one percentage point increase in the representation rate, it translates into a one and a half percent impact on the BI severity trend.[132]

78. Some parties appear to be equating ICBC's assessment of the significance of the legal representation rate to "blaming the lawyers". This is a significant oversimplification, and it does a disservice to what ICBC is saying and trying to accomplish. As Ms. Minogue stated in response to Mr. Adair: "In the IRs and the communication that you just referred to, it's not blaming lawyers. It's saying there is more legal representation. So I think there is a clear distinction of what that is."[133] It is undisputable that: (a) the legal representation rate is

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[128] T5: 771, ll.17-26.

[129] 2013.1 RR BCUC.105.2.

[130] 2013.1 RR BCUC.105.2.

[131] 2013.1 RR BCUC.105.2.

[132] 2013.1 RR BCUC.7.2; T3: 442, l.17 to 443, l.1. The calculation of the correlation coefficient is included in 2013.2 RR BCUC.166.1-2.

[133] T3: 441, ll.18-22.

accelerating; and (b) a big part of the increase is attributable to more files coming in to ICBC already represented.[134]

(b) Drivers of the Legal Representation Rate

79. ICBC has addressed in detail the drivers of the legal representation rate in the response to 2013.1 RR BCUC 154.4. In that response, ICBC explained that the causes of legal representation are complex. A certain degree of legal representation is inherent in British Columbia's full tort system, under which the injured party must prove both negligence and damages against another person or persons. The rate of representation is increasing, and beginning in 2012 has been increasing at an accelerated rate. ICBC is still studying this phenomenon. It is nevertheless able to identify a number of factors likely contributing to the acceleration, some of which are outside ICBC's control and some over which ICBC has influence. For simplicity, Mr. Wilson grouped the factors into three "buckets" as follows: [135]

> I think that when we looked at the acceleration in 2012 there's three buckets or there's three areas that we put it into. And so the short answer is there's no one single reason.
>
> If we look at internal people and processes, this is what I would refer to as what ICBC can do once we have the claim. We realized that there are always pressures on ICBC to deliver a good service and that there was some impacts to this service during our transition, which I would put as the second point. We recognized that during the transition period we moved people around, we moved files around, we changed our structure, and that impact I expect to be shortened, not to be sustained over a long period of time but simply a transitional impact.
>
> We did look at our -- we continuously look at our internal people and processes and what we call frustrations that can lead people to get a lawyer, and we've implemented some initiatives in 2013 which we hope to improve the customer's understanding of their benefits in the process, and to improve the customer experience.
>
> The third point which we noticed in 2012 is what we call early legal representation, or it's someone's choice to get a lawyer before they even come

[134] 2013.1 RR BCUC.105.1.

[135] T4: 658, l.12 to 660, l.14.

> to ICBC. So when I talk about internal improvements so that we improve customer experience or transitional impacts due to moving files around, those two aren't affected or aren't impacted by the recent trend in accelerated representation before they come to ICBC. And we've referred to that in 154.4. But also in 154.2 we discussed that ICBC is doing some analysis to what are the attributes or the attitudes of people, or people that are influencing customers to get a lawyer before coming to ICBC.
>
> So it's really three areas. The first area is an ongoing pressure that ICBC hopes to improve, not only with the new organizational structure, but also with the new system. The transitional impacts, we expect to be just that, transitional, and we don't expect them to go all the way through to 2016 because there will be some -- the training is completed before 2016 and the staff will be more adept on the systems and will have the new case loads prior to 2016.
>
> The final point, the choice of people to get a lawyer before coming to ICBC, we've addressed some of those concerns already in areas such as better service to multicultural customers and better explanation of the process to people.
>
> But this is a corporate initiative and this is something that we address also in TREAD 19.1, round 2, where we really have all areas of the corporation looking at what it is that they can do to understand and impact people's decisions to get a lawyer.

80. In the IRs and at the hearing, parties focussed more on ICBC's role than the variety of other factors at play. While it is certainly true that claimants may go to a lawyer if they are "frustrated by a process" or the "perception that they are not getting what they think the claim is worth",[136] much of the current acceleration is attributable to more claims arriving at ICBC already represented. This fact suggests that new factors external to ICBC are also at play. This may include specific attitudes or perceptions of ICBC that go well beyond how a claim is handled.[137] For instance, ICBC is already aware that there are many misperceptions of ICBC's role in the process, including that ICBC is an "institutional defendant" with "unlimited resources" (with no recognition of the link between claims costs and premiums).[138] ICBC is surveying a large sample of ICBC policyholders to develop a deeper understanding of its customers' perceptions as they relate to legal representation.

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[136] T2: 222, l.16 to 223, l.2; 2013.1 RR BCUC.154.4.

[137] Investigating this phenomenon is not a simple matter of asking represented claimants people why they have chosen to retain a lawyer; once a claimant is represented, ICBC must deal only with the claimant's lawyer.

[138] 2013.2 RR TREAD.18.2.

81. Mr. Wilson explained:[139]

> And this goes to a corporate effort at not only looking at what we can do once they report to us, but what we can control about their perceptions about ICBC or the process. So we're going in really with our eyes wide open. We acknowledge that we do have a little bit to learn here in terms of what are the current perceptions, and how are our processes and policies working.

The results of the pending study on legal representation will help inform ICBC on ways to adapt and modify existing initiatives, or establish new ones, to help address the legal representation rate. ICBC expects that information will become available during the 2014 RRA process.[140]

(c) Taking Appropriate Steps to Address Costs Associated with Legal Representation

82. ICBC is taking appropriate steps within its control to address the costs associated with the accelerating legal representation rate.

83. Mr. Wilson explained that ICBC's focus is on taking appropriate steps to avoid people retaining legal representation in cases where it is not necessary.[141] The steps being taken are informed by what customers have indicated they want from ICBC:

> What ICBC tries to control is the cases where it's unnecessary. There aren't issues in dispute, there is certainly not issues that we can't resolve. And when we talk about what a customer wants in terms of settlement, it's not just they want to get a fair settlement. What our customers have told us is, they also want to be treated fairly. They want to be given their benefits and their time to get better up front. And they want to be explained what their entitlements are. And when we settle a claim, they want us to make it very clear what we're paying for. And to the effect that we don't do a good job at that, they may get a lawyer simply because they feel we're not meeting their needs.

There are a variety of ways in which ICBC is addressing these expectations and making it easier for claimants to proceed through the process without legal representation. The evidence is summarized below.

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[139] T5: 756, ll.13-23.

[140] 2013.2 RR BCUC.199.1; T5: 755, ll.20-24.

[141] T3: 435, l.6 to 436, l.3.

- ***Consistency in file management***: One benefit of reorganizing the Claims Division from a regional-based model to a functional model where all unrepresented claims are under one Director is that ICBC has greater ability to: set performance and accountability standards specifically on managing the unrepresented claimant and on representation rates; identify positive and negative performance outliers; share best practices; and, improve consistency in the way in which ICBC negotiates with unrepresented claimants.[142]

- ***Greater specialization among adjusters***: Streaming claims to more specialized adjusters is also expected to have a favourable influence on representation rates. ICBC explains that "Having an adjuster who is better trained to address the immediate needs of an injured customer and is managing a case load of only unrepresented claims, will allow them to better interact with unrepresented claimants and provide more consistent and timely service."[143]

- ***Ease of interaction***: ICBC has expanded the Centralized Claims Injury Centre (CCIC) to include more claims. The team-based call centre model used has proven to be a successful model with low representation rates and high settlement rates.[144]

- ***Addressing points of friction***: ICBC discontinued the Low Velocity Impact (LVI) program in 2013 when it became clear that, after many years of success in managing claims costs (a) the benefits were no longer as significant and (b) the program had also become a source of frustration for claimants that was contributing to higher legal representation rates because it took the decision-making and accountability away from the adjuster and caused delays.[145] Ms. Taylor explained that the corporate decision was:

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[142] 2013.1 RR BCUC.154.4, Attachment A, p.7; 2013.2 RR BCUC.160.1.

[143] 2013.1 RR BCUC.154.4, Attachment A, p.7.

[144] 2013.1 RR BCUC.154.4, Attachment A, p.7; 2013.2 RR BCUC.201.1 to 2013.2 RR BCUC.201.4.

[145] 2013.1 RR BCUC.154.4, Attachment A, p. 8; 2013.2 RR BCUC.200.1 and 2013.2 RR BCUC.200.2.

> …we want customers to get their answers -- their questions asked when they first phone in. We don't want them to have to go to a claims centre. And if it's straightforward, we don't want a lot of process.
>
> An adjuster should be able to say that's compensable or not. That was completely contradictory to the LVIU (sic- LVI) program which, as you pointed out, was a huge committee with a number of managers and 20 years later, much different than the direction we're going in now.[146]

ICBC has now "taken the committee process out", "taken out the measurement of the vehicle speed change through isolators", "given that responsibility to adjusters to assess the claim on its merits" and "given them the tools and training to assess those claims" based on the damage to the vehicle, witnesses, the parties' statements, and medical information.[147]

- ***Improved information at first notice of loss*:** ICBC is making it easier for people to understand the process and their entitlements when they first come to ICBC with their claim. This initiative can potentially influence the legal representation rate because it will help to address a feeling that a lawyer is required to navigate the process.[148]

- ***Faster access to Accident Benefits*:** ICBC is also making it easier for injured claimants to obtain the Accident Benefits to which they are entitled sooner and have all other immediate needs addressed when they first come to ICBC with their claim.[149] Ms. Taylor described in detail how the nature of that first interaction with a claimant is changing for the better.[150] ICBC expects "that process is going to be very helpful in getting our customers to access their benefits earlier and to have an earlier recovery time."[151] This expectation of a

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[146] T2: 237, l.19 to 238, l.14.

[147] T3: 318, l.18 to 319, l.7.

[148] 2013.1 RR BCUC.154.4, Attachment A, pp. 8-9; 2013.2 RR BCUC.160.1.

[149] 2013.2 RR BCUC.160.1; 2013.1 RR BCUC.154.4, Attachment A, p. 9.

[150] T2: 273, l.2 to 274, l.8.

[151] T2: 261, ll.14-26. See also T3: 477, l.1 to 478, l.3.

favourable influence due to this initiative, in tandem with other initiatives, on the BI claims costs is reflected in the actuarial rate indication.[152] That is, without these efforts, the Accident Benefits costs used in the Application might have been lower, but the BI claims costs would be higher.[153]

- ***Improved training of service representatives***: Improved training is important, and is facilitated by data collection and file reviews. Mr. Wilson encapsulated this point in response to questions from Ms. Khan:[154]

> We have customer surveys which survey a person at different points in the life of file, and we can use those surveys to go back to the issue. And if a lot of customers are finding dissatisfaction with not returning phone calls or not understanding the process, for example, we would address that system across the culture. Where it points to a certain adjuster, we can see that adjusters may have lower customer satisfaction. They may also have higher legal representation rate. The two may not correlate, but it certainly points us in the right direction. And that's how we use reports to focus the adjusters on -- and their managers on the right files. So when we look at authority and manager reviews, that's not a bad thing. That's a good thing, if you've got the tools to say, "Where do we need more coaching and help?"

- ***Language line***: ICBC has recognized that legal representation rates are higher among certain ethnic communities, and is putting systems in place to make the process more accessible to people whose first language is not English from the outset without the need to go to a lawyer.[155] The Punjabi language line is already implemented, soon to be followed by a Cantonese and Mandarin line (anticipated date is currently the end of 2014).[156] People can still go to their local claim centre where there is a good likelihood that there will be adjusters

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[152] T2: 262, l.13 to 263, l.21.

[153] 2013.2 RR BCUC.191.1; 2013.2 RR BCUC.191.2; 2013.1 RR BCUC.7.1 and 2013.1 RR BCUC.7.2; T5: 769, l.11 to 771, l.26.

[154] T3: 324, ll.7-25.

[155] 2013.1 RR BCUC.111.1; 2013.1 RR BCUC.111.2; 2013.2 RR BCUC.160.1; 2013.2 RR BCUC.196.1.

[156] T3: 329, ll. 1-2.

that speak Punjabi, Cantonese or Mandarin. However, the new features mean that now they can also have the option of faster access by telephone.[157]

84. ICBC is looking for ways to manage claims better and continually reassesses its existing programs.[158] Ms. Taylor stated:

> We are continually looking at our policies to see if it is having the intended outcome that we want. And you know, as time goes by, or we do -- we look at all of our procedures or policies to make sure that it's getting the outcome that is intended.
>
> Expectations of customers also change over time. And I think it's important for us to address those as well. So to your question do I think it's important that we should, I totally -- I do agree with that and I would say that we do that, and we will continue to do that.[159]

In this vein, Ms. Taylor indicated that it would be important for ICBC to evaluate the First Notice of Loss initiative (i.e. meeting customer needs at point of first call) well before the five year mark to ensure that the early payment of Accident Benefits is helping to address overall claims costs, improving recovery time for injured claimants or generating positive customer feedback.[160]

(d) AIC's Suggestion that New Organization is Bureaucratic is Misinformed

85. AIC appeared to be suggesting during cross-examination that the combined effect of (a) the new organizational structure and (b) the improved ability of management to understand how individual adjusters are handling their case loads, leads to increased management interference and a demoralized workforce that drives higher representation rates. The evidence does not support AIC's hypothesis:

- The new organizational structure makes ICBC more responsive to claimants for the reasons previously described.

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[157] T3: 327, l.25 to 328, l.22.
[158] 2013.2 RR BCUC.200.3.
[159] T2: 251, ll.10-21.
[160] T2: 274, l.16 to 276, l.4.

- Mr. Wilson explained that adjusters have ample authority to settle most files and rarely need to involve their manager.[161] There is less process for the vast majority of customers; they can call ICBC 24 hours a day and don't have to come into a claim centre. The oversight referred to by counsel for AIC as the basis for this suggestion are only employed with the complex litigation where it makes sense to have a "second set of eyes", and not the less complex unrepresented claims.[162] As for the more complex claims, Ms. Taylor explained why it is important to have more processes involved: "…I think for us to be prudent, to make sure we're doing the best we can to defend our defendant, as well as the 3.3 million policyholders, yes, there are more processes and more people involved, because it is relevant to the risk and complexity of that file. And I think that is the prudent thing to do."[163]

- ICBC has acknowledged that any time there are significant business changes, it takes time for employees to readjust. However, the changes have to be made and they are moving in the right direction for facilitating ICBC's interaction with claimants. Once ICBC is through the initial transition period, these initiatives will ultimately improve ICBC's ability to combat accelerating legal representation rates.[164]

- ICBC's Claims Services Satisfaction scores have remained consistent for a number of years.[165]

D. ROAD SAFETY INITIATIVES (INCLUDING DISTRACTED DRIVING)

86. ICBC also manages claims costs through its Road Safety initiatives. ICBC makes three points below:

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[161] T2: 215 ll.2-9; T2: 223, l.19 to 224, l.16.
[162] T2: 223, l.16 to 224, l.16.
[163] T2: 225, ll.18-25; see also: T2: 213, l.11 to 215, l.9.
[164] T4: 496, ll.13-20.
[165] 2013.1 RR BCUC.144.1.

- First, ICBC is refocusing the Road Safety department on the BI frequency issue, including PED use while operating a vehicle;
- Second, ICBC investigates distracted driving where that would affect the outcome of a claim, which is appropriate given the legal parameters; and
- Third, the Road Safety department has undertaken a number of steps to better understand distracted driving and is beginning to review initiatives to respond to it.

(a) Re-focussing Road Safety Programs on BI Frequency

87. ICBC is taking appropriate steps to re-focus the Road Safety department on the BI frequency issue, including PED use while operating a vehicle.

General BI-Focussed Strategies

88. Mr. Dickinson described how the Road Safety department has been working with the Advanced Analytics team (Mr. Loach's group) to review data and assess countermeasures to identify potential improvements. He gave a number of examples of initiatives such as promoting head restraints, and engineering solutions to prevent rear-end collisions and pedestrian and cyclist crashes.[166] ICBC is currently reviewing the intersection safety camera program to assess its effectiveness as well.[167] As discussed below, ICBC is also paying particular attention to distracted driving.

Road Safety Response to Distracted Driving

89. Global best practice is to use a "three pillar" approach to reducing any type of crash. The "three pillars" are legislation, enforcement, and education and awareness. Currently, ICBC promotes education and awareness tactics and supports police enforcement activities associated with distracted driving during the month of September as per the police

[166] T6: 881, l.17 to 883, l.24.
[167] T6: 885, l.6 to 886, l.3.

campaign schedule.[168] Police have added a second enforcement period in 2014, which ICBC is also supporting.[169] ICBC has generated significant "earned media" from its efforts[170], and Mr. Dickinson noted that ICBC is also reallocating funds towards distracted driving: "…we need to prioritize, like with distracted driving and the frequency curve I do think that that needs to be a focus. And we are looking at shifting our resources within that [education and awareness] bucket of money to do some more around distracted driving."[171]

90. ICBC is reviewing initiatives to reduce PED use while driving in the context of the "three pillars". The work will include (a) reviewing ICBC's own data on PED use, (b) assessing best practices and program effectiveness in other jurisdictions, (c) collaborating with interested stakeholders, and (d) enhancing education awareness, all with the aim of developing an enhanced approach to the issue of distracted driving.[172]

(b) Addressing PED Use in the Context of Processing Claims

91. Mr. Wilson provided the assurance that the Claims Division is "very committed to investigating claims and where relevant, investigating PED or anything that would increase liability and that would lead us to holding someone liable or not liable properly."[173] ICBC recognizes that gathering more data on PED use would be beneficial (as Mr. Wilson put it, "the more we know about emerging technology the better").[174] However, there are technological and legal limits on the extent to which the Claims Division can gather data on distracted driving:

- ICBC does not currently have the ability to track PED use data under legacy systems in a manner that makes it useful for statistical analysis. This may be possible under ICBC's new system.[175]

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[168] 2013.2 RR BCUC.203.2; 2013.1 RR IBC.25.1.

[169] 2013.2 RR BCUC.203.2; 2013.1 RR IBC.25.1.

[170] T6: 895, l.18 to 896, l.3.

[171] T6: 978, ll.12-22.

[172] 2013.2 RR TREAD.13.1; T6: 889, l.11 to 893, l.26.

[173] T3: 420, ll.9-13.

[174] T3: 421, ll.18-19; T2: 269, ll.5-26.

[175] The data, when collected, is currently reflected in the statement itself rather than being coded separately. T2: 268, ll.14-25; T2 270, l.17 to 271, l.12.

- System capability is only part of the issue when it comes to tracking information; there are also legal limits on ICBC's ability to gather and use data. While people tend to equate the relevance of PED use with impaired driving, the analogy is not accurate. Impaired driving is relevant in all circumstances because it is a policy breach. The same is not true for PED use. ICBC cannot, for instance, enforce collection of data on PED use when liability is admitted or self-evident - it is not relevant to damages. Mr. Wilson identified two circumstances where the records are relevant and where ICBC can apply to court to compel records of PED use:

  - Where there is some evidence that somebody was using a PED device, and yet they denied using it, and that the use of the PED device contributed or caused the accident; and

  - Where there is evidence of fraud, and PED records may show coordination among individuals involved.[176]

  In the absence of being able to compel responses, intuitively the reliability of the data would be challenged by virtue of the fact that people would be more willing to volunteer that they had not been using a PED than to volunteer that they had been using one.

92. Mr. Wilson summed up by noting that, wholly apart from the legal constraints, attempting to pursue this information when it is neither relevant nor compellable at law may cause more friction between claimants and ICBC at a time when ICBC is attempting to facilitate that relationship:

> I don't disagree with you, sir, that that's something that would be nice to have. It's the ability to compel them. And with the current -- with our current focus on representation rate, and improving the customer experience, to put someone in a position where you are asking a question that's not relevant or enforceable, at

[176] T3: 421, l.11 to 422, l.15.

> this point, as long as it doesn't affect their insurance, isn't something that we feel would help our customers.[177]

93. In summary, the Claims Division is taking appropriate steps to gather and record information on PED use.

E. COMBATTING FRAUD

94. Fraud was a topic canvassed by some parties at the hearing.[178] The evidence demonstrates that (a) ICBC continues to pay appropriate attention to combatting fraud, and (b) ICBC has been incorporating new methods and tools to address this important issue.[179]

95. Mr. Wilson discussed, for instance, how ICBC is proceeding immediately with organizational changes that will use existing resources efficiently and effectively. For instance, ICBC has "reallocated our resources in our Special Investigation Unit department to try and align with a specific type of claim. So an example is an SIU officer that works with all of the people that handle stolen vehicles, adjusters. And so by understanding that arena, you get a better idea of not only red flags, but what the occurrence is that you're catching."[180] Mr. Wilson testified that "Currently we have redeployed our resources so that we feel that we've covered all of the areas based on where they can have an impact and, by training adjusters."[181]

96. ICBC has "also broadened the scope of their investigations significantly by having a dedicated team looking at what we call cyber-research, or internet. And that's consistent with many law enforcement and insurance companies. That's what we have the capability to do before the new system under the structure."[182]

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[177] T2: 269, ll.5-26.

[178] The discussion starts at T2: 284, l.25.

[179] 2013.2 RR BCUC.195.6. Undertaking 2013 RR BCPSO.UT.1 provides summary information on recent fraud investigations.

[180] T2: 288, l.22 to 289, l.18.

[181] T2: 291, l.18 to 292, l.12. See also 2013.2 RR BCUC.195.6; T2: 295, ll.14-26 and T5: 741, l.12 to 742, l.1.

[182] T2: 290, ll.18-24. See also 2013.1 RR BCUC.111.4

97. The new system will provide ICBC with better data to flag certain fraudulent indicators, which will help ICBC to identify fraud earlier and better focus its resources.[183] ICBC is currently working to understand the indicators of fraud so that the system can be designed around that information.[184]

98. Ms. Taylor discussed at the hearing ICBC's analysis when assessing fraud deterrence.[185] She and Mr. Wilson also discussed how ICBC prioritizes and oversees its fraud investigations.[186] Their responses demonstrate that ICBC is approaching fraud in a responsible and pragmatic fashion.

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[183] T2: 286, l.18 to 287, l.6; T2: 290, l.25 to 291, l.8.

[184] T2: 293, ll.2-14.

[185] T5: 746, l.12 to 748, l.11.

[186] T5: 748, l.12 to 751, l.3.

PART FIVE: PERFORMANCE MEASURES

99. ICBC reports on performance measures. There were some questions in information requests and at the hearing exploring the types of measures that should be subject to reporting. Ms. Prior explained that, for efficiency reasons, a comprehensive review of performance measures should await for the completion of claims transformation:[187]

> Yes, there's a number of changes that we're doing organizationally. It's not just the systems but it's also the way that we're going to be servicing the policies and the customers. So it drives changes in our processes and we think we need to kind of let those settle in because that's where the performance will be driven from. To do it in between as we're going through that transition didn't seem to make sense to us.

Based on the current timeline for transformation, this would likely mean filing a proposal as part of the 2017 RRA. Nevertheless, ICBC did agree to begin reporting on BI frequency. The Commission can and should eliminate some of the existing measures now where they have clearly outlived their usefulness. The witnesses identified some of the outdated measures, and explained why it no longer makes sense to report on them. It is inefficient to require ICBC to continue, pending a comprehensive review, to report on matters when it is already self-evident that they no longer have relevance to the way in which ICBC does business.[188]

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[187] T7: 1148, ll.6-14.

[188] T7: 1149, l.8 to 1151, l.18.

PART SIX: PROPOSED CAPITAL MANAGEMENT PLAN

A. INTRODUCTION

100. In this Part, ICBC addresses the proposed CMP for PY 2014 and beyond. The impetus for ICBC's proposed CMP is the new rate smoothing framework established by *Special Direction IC2* and the 2013 Government Directive regarding Rate Smoothing. ICBC is specifically directed to apply to the Commission for a new CMP for approval before May 31, 2014.[189] The proposed elements of the new CMP, to a material extent, flow from the specifics of the legislated rate smoothing framework. On the matters over which the Commission retains discretion, ICBC has put forward reasonable proposals.[190]

101. ICBC makes the following points below:

- First, the rate exclusion provisions dictated by *Special Direction IC2* necessitate a new capital management target and new capital management provisions to align with and address the exclusions;
- Second, the proposed capital management target of 150% strikes a balance between having enough capital to smooth rates through ordinary loss cost forecast variance scenarios while limiting the rate impact on customers due to the building of capital to the new capital management target;[191] and
- Third, the proposed terms of the customer renewal credit (CRC) appropriately address circumstances where there has been an unintended accumulation of excess capital, without unduly impairing rate smoothing or adding solvency risk.

B. THE RATE EXCLUSION (RELEASE) AND BUILD PROVISIONS IN *SPECIAL DIRECTION IC2*

102. Section 3(1)(c.2)(ii) of Special Direction IC2 provides for the exclusion of costs from the Basic rate indication that would otherwise be fully covered under accepted actuarial

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[189] 2013 Government Directive regarding Rate Smoothing.

[190] A good discussion comparing the existing CMP to the proposed CMP begins at T5: 782, l.4.

[191] Chapter 4, para.43.

practice.[192] The rate exclusion, which is effectively a capital release provision (and replaces the existing capital release provision), occurs in two circumstances. Section 3(1)(c.2)(ii) provides that for 2014 and each following year for which rates are set:

> (A) the commission may exclude some or all of that year's loss costs forecast variance from the rate fixed by a general rate change order in accordance with a capital management plan approved by the Commission [Requirement (A)], and
>
> (B) the percentage number of a rate change fixed by a general rate change order must differ from the percentage number of a rate change fixed by the previous general rate change order by no more than 1.5, and must not decrease existing rates [Requirement (B)].

103. Requirements (A) and (B) help to manage the volatility in rates. Requirement (A) does so by excluding a component of the rate indication that is typically a source of rate volatility. Requirement (B) caps the rate increase. In both cases, ICBC is afforded time to address any new cost pressures and then possibly mitigate or reverse them.[193] The operation of these provisions, and the rationale for them, is best understood using the illustrations included in Chapter 4, pages 4-15 to 4-23.

104. The implication of Requirements (A) and (B) is that the proposed new Basic Capital Management Plan must provide for (i) a new capital management target, (ii) capital management provisions to account for the capital release inherent in (A) and (B), and (iii) maintaining and building capital. The next section addresses the capital management target. The rate of capital build, which was not the focus of many IRs or questions, is addressed in Chapter 4, starting at page 4-18. The capital maintenance provision is addressed later in this Part of the Submissions.

C. THE PROPOSED CAPITAL MANAGEMENT TARGET IS APPROPRIATE

105. *Special Direction IC2* defines the "capital management target" as the sum of three components:

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[192] 2013.1 RR BCUC.62.1.

[193] T3: 385, ll.16-23; T3: 389, ll.6-18.

> (a) the MCT required under section 3 (1)(b); [i.e., 100% MCT]
>
> (b) the margin, expressed in percentage points of MCT, that reflects the corporation's risk profile in relation to the corporation's universal compulsory vehicle insurance business and its ability to respond to adverse events that arise from those risks;
>
> (c) any additional margin, expressed in percentage points of MCT, consistent with relatively stable and predictable universal compulsory vehicle insurance rates;

Based on those requirements, ICBC is proposing a capital management target of 150% MCT, which is an increase of 20 percentage points from the existing approved target of 130% MCT. ICBC makes the following points in this section:

- First, since the current target of 130% MCT is based on ICBC's risk profile, the stipulated criteria suggest a capital management target that is above the current target of 130% MCT; and
- Second, the proposed capital management target of 150% MCT strikes a balance between having enough capital to smooth rates through ordinary loss cost forecast variance scenarios while limiting the rate impact on customers due to the building of capital to the new capital management target.[194]

(a) The Risk Based Margin for Solvency Should Remain 30 Percentage Points

106. Subparagraph (b) of the "capital management plan" definition requires a margin based on the Basic insurance "risk profile" and "its ability to respond to adverse events that arise from those risks". The risk based margin should remain 30 percentage points.

107. Mr. Weiland described how the 30 percentage point margin inherent in the existing 130% capital management target was derived through the application of industry standard risk analysis (called Dynamic Capital Adequacy Testing, or DCAT):[195]

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[194] Chapter 4, para. 43.

[195] T4: 543, l.13 to 544, l.4.

> The methods used to establish that 130 percent was an appropriate capital target for ICBC's basic insurance were standard approaches used by actuaries in Canada, as Ms. Minogue has said, and those approaches involve looking at a variety of different risks and establishing the impact should one of those risks actually emerge. And the risks are evaluated at a level of approximately 10 percent probability.
>
> So we look at what is the impact from a one in ten year event and say the capital required at 100 percent is so much, we need to be able to withstand that 1 in 10 year event and still remain at 100 percent MCT or higher. So that was the basis, and in the broadest of terms, for the approach that was used to get to the 130 percent target. That analysis was filed with the Commission and there is a significant amount of detailed support for the 130 percent target.

Mr. Weiland confirmed that the 30 percentage point margin that was the outcome of the DCAT analysis does not cover all adverse scenarios. Rather, it is designed "to give management time to deal with issues so that responses can be constructed so that we will remain above 100."[196] None of the plausible adverse scenarios included in the DCAT incorporated a specific provision to maintain relatively stable and predictable rates.[197]

108. The current risk-based 130% capital management target was confirmed in a series of Commission Decisions beginning in 2007.

- The Commission concluded in the 2006 Revenue Requirements Decision[198] that the capital management target had to be in excess of 100% to address the financial stability of Basic insurance:

> Eckler Partners, ICBC's consulting actuaries, undertook DCAT analysis and determined that if the Basic Insurance had a MCT ratio of 130 percent, it could withstand an event, such as the four adverse scenarios described in the Eckler report, once every six or seven years and still meet the minimum regulatory MCT requirement of a 100 percent MCT ratio [footnote omitted]
>
> ICBC's decision to limit the Basic Insurance capital management target MCT ratio to the statutory minimum of 100 percent

[196] T4: 544, ll.11-21.

[197] 2013.2 RR BCUC.181.1.

[198] 2006 RRA Decision, July 13, 2006, pp. 24-25.

> effectively ignores, in the view of the Commission Panel, the results of the DCAT adverse scenarios and consideration of other plausible scenarios. The Commission Panel considers that by so doing, ICBC is exposing the Basic Insurance business to an unacceptable level of risk of failing to attain, and then maintain, at least the required statutory minimum.
>
> In view of the Commission Panel ICBC has strayed from the application of accepted actuarial practice by not establishing a capital management target for Basic that will result in at least "…a minimum satisfactory financial condition under all of the adverse scenarios tested and provides a reasonable buffer to decrease the likelihood of falling below the regulatory minimum 100% for the Basic Insurance business. [footnote omitted] (The Commission Panel differentiates between the statutory minimum and the regulatory target to be established by the Commission.)

- The Commission revisited the capital management target again in 2007,[199] and ultimately accepted 130% based on additional risk analysis information provided by ICBC.

- The Commission again reiterated the logic of a 130% MCT management target to address solvency in the 2012 RRA Decision:[200]

> ICBC's Capital Management Target ratio of 130 percent, accepted by the Commission in an earlier decision, is intended to provide a cushion to absorb the impact of 'adverse events', a number of which have been and/or continue to be experienced by ICBC, including increasing loss costs, and fluctuations in interest rates, yields, portfolio and asset values. The forecast December 31, 2012 MCT ratio of 108 percent, based on the 11.2 percent rate increase, is uncomfortably low, with little 'cushion' left to protect the minimum capital requirement.
>
> …
>
> The Panel understands the dilemmas facing ICBC, including forecasting the dynamic and volatile components of the rate indication. The Panel's view is that the primary concern for ICBC's

[199] 2007 RRA Decision, January 9, 2008, pp.13-17.

[200] 2012 RRA Decision, August 16, 2012, pp.45-46.

> policyholders should be the financial health and solvency of the Basic Insurance business, as expressed by the Commission in previous decisions, and implicit in the regulatory requirement for the Commission to set rates which permit ICBC to earn revenue sufficient to maintain the MCT ratio at or above 100 percent.

109. As is evident from the above quotations from past Commission decisions, considerations regarding rate stability and predictability, although reflected in other components of the CMP (e.g., the rate at which ICBC would build or release capital to move towards the capital management target), did not come into play when determining the capital management target itself. ICBC thus refers to the existing target as the "Solvency Target" in the context of the new CMP.

110. ICBC and Mr. Weiland confirmed, based on a recent DCAT analysis, that a solvency target of 130% MCT remains appropriate given the volatility in the Basic insurance business.[201] ICBC's existing 130% MCT target is well below the capital management targets required for OSFI-regulated private insurers,[202] which reflects the fact that ICBC's DCAT analysis does not include scenarios relevant to corporations that face competitive risks and loss of market share.[203]

111. ICBC explained that a lower solvency target of 120% MCT, for instance, would not be able to maintain Basic capital above the regulatory minimum MCT of 100% in the event of certain plausible adverse scenarios. Volatility in the investment market alone can easily impact the Basic MCT ratio by 15 percentage points. If any other additional adverse events were to occur simultaneously, such as adverse development in BI claims, then the MCT ratio could be expected to fall below the regulatory minimum. [204] Mr. Weiland described falling below 100% MCT as "quite a serious matter".[205] In essence, moving to a solvency target below

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[201] 2013.2 RR BCUC.180.1; T4: 656, ll.7-10; T5: 678, l.18 to 679, l.7.

[202] 2013.1 RR BCUC.69.6. Even OSFI's "supervisory target", or the level that prompts supervisory action on the part of OSFI, is 150% MCT.

[203] T4: 509, ll.6-23; T5: 682, l.23 to 684, l.9; T5: 685, l.22 to 686, l.8.

[204] 2013.1 RR BCUC.66.4 and 2013.1 RR BCUC.82.1.

[205] T4: 506, l.24 to 507, l.11.

130% would, in light of the available risk assessment evidence, contradict the Commission's previous determinations.

112. Mr. McCandless used Manitoba Public Insurance's (MPI) practice of establishing a capital reserve based on a percentage of premiums written to suggest that ICBC's Solvency Target is set too high. The fact that MPI's regulator[206] requires it to manage to a target equivalent to 44% MCT says nothing about the appropriateness of ICBC's Solvency Target of 130% MCT. While MPI may be required to set capital reserve targets based on a percentage of premiums written, ICBC's evidence is that basing capital management targets on a percentage of premiums written is not a practice otherwise used in the industry.[207] MPI itself opposes the approach taken by its regulator because the amount of premiums written bears no relationship to risk. MPI's actuaries have been unable to certify that MPI's compulsory insurance product has a satisfactory financial condition because of low capital levels.[208]

(b) Proposed 150% Target Considers Volatility and Rate Impacts

113. Since the current target of 130% MCT is based on risk (the second component of the definition of "capital management target"), the stipulated criteria in the definition suggest a capital management target that is above the current target of 130% MCT. ICBC has advanced a compelling rationale for why there should be an additional margin of 20 percentage points for rate smoothing. In essence, the 20 percentage point margin balances the likelihood of significant fluctuations in Basic capital occurring as a result of rate smoothing (i.e., setting rates lower than required to cover costs), as well as the impact of a rate smoothing margin on customers.

114. ICBC first explained that a 20 percentage point margin was appropriate in light of ICBC's past forecast variances. It would have been sufficient to handle some of ICBC's recent variances, but certainly not all circumstances.

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[206] The Manitoba Public Utilities Board (PUB), not OSFI.
[207] 2013.1 RR BCUC.69.5.
[208] 2013 RR BCUC.UT.7.

- The 20 point margin works well for absorbing a significant *single year* loss cost forecast variance.[209] ICBC walked through the details of this calculation in Chapter 4[210] and provided additional explanation in the responses to 2013.1 RR BCUC.66.2 and 66.4. Ms. Minogue also spoke to those IRs at the hearing, and provided a useful shorthand for understanding how Basic capital is affected by a single year variance:[211]

> So again, let me just start from first principles here. So assuming that you're at the 150 and you experience -- let's just round numbers, a 5 point forecast variance, that'll eat ten points of capital. So now you're down to 140 and now you want to bring that smoothly back into rates and so you might need to use five and then two and a half. So you can see that you need the 20-point margin for that.

  She added: "It's not surprising to an actuary that when you have a standard deviation around forecast variances of 3.4, and a rate smoothing mechanism that brings it in smoothly over time, that you'll land on about a 20 point margin…".[212] The volatility assumptions that form a basis for the recommendation of 20 percentage points are also supported by the experience in Alberta, another tort jurisdiction.[213]

- While a significant single year variance can be addressed by ICBC's proposal, 20 points of MCT would not have been adequate to smooth through the recent two-year cumulative loss cost forecast variance.[214]

Hence, it is appropriate to characterize the 20 point margin as striking a balance to smooth through more likely loss cost forecast variance scenarios and at the same time limit the rate impact on customers. Ms. Minogue confirmed that "even with a twenty-point margin the

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[209] 2013.1 RR BCUC.68.1.
[210] Chapter 4, paras. 37-43.
[211] T5: 687, l.16 to 690, l.13.
[212] T5: 697, ll.7-11.
[213] T5: 693, l.21 to 694, l.8.
[214] 2013.1 RR BCUC.68.1.

burden on the customer is not that great. It's a short-term impact that gets added to the rate and then removed once the capital is at the right level."[215]

115. The 20 percent margin is further supported by a recent DCAT analysis that tested for the additional risk to Basic insurance posed by rate smoothing (i.e., setting deficient rates and using capital to smooth out variances).[216]

116. With only a 10 percentage point margin above the solvency target, for instance, the amount of rate smoothing that could be done by excluding a portion of the loss cost forecast variance would be "very limited" unless the Commission is prepared to use capital below 130% MCT to implement rate smoothing.[217] Neither of these options are good ones.

- Unduly limiting the amount of capital available to the point where it is insufficient to address expected volatility would undermine the intent of Government's rate smoothing framework.

- At the same time, allowing capital designated for solvency purposes to be used for managing rate volatility (a) is not in the long-term interest of policyholders in having a financially sound Basic insurance product, and (b) conflicts with the Commission's past decisions on the importance of the 130% target for maintaining solvency. Ms. Minogue put it bluntly (and aptly) in response to questions from Mr. Miller: "I'm not sure why you're saying why isn't that reasonable? You've, you know, you've basically accounted for forecast variance that's foreseeable and decided to use your solvency capital, and so you're intentionally going below the 130 just to smooth through rates. And in my view that's not what the intention of the IC-2 is."[218]

117. The Commission is not in a position where it has to choose between rate smoothing and solvency. ICBC explained above that the proposed 20 percentage point margin

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[215] T5: 694, l.16 to 695, l.4.
[216] 2013.2 RR BCUC.180.1; 2013.2 RR BCUC.180.2; T5: 696, ll.8-26.
[217] 2013.1 RR BCUC.66.4.
[218] T5: 691, ll.15-21.

is also expected to have a minimal impact on rates.[219] In light of all of the facts, ICBC submits that a 20 point margin is the most logical approach.

D. CAPITAL MAINTENANCE PROVISION

118. The purpose of the capital maintenance provision will continue to be to provide the growth in capital in proportion to the growth in ICBC's business.[220] There are two primary considerations in the determination of a new capital maintenance provision: (1) the desired level at which to maintain the MCT ratio; and (2) the assumed growth rate in the capital required. ICBC is only proposing to change the former. ICBC summed up its proposed change and the rationale for it as follows:

> ICBC is proposing a new capital management target MCT ratio of 150%, in which a higher capital maintenance provision would now be required. Similar to the situation in the current Capital Management Plan, ICBC proposes to transition to the new management target of 150% over a number of years. However, rather than using a 20 year period, ICBC is proposing to shorten the transition period to 10 years. This again strikes a balance between limiting the impact on customers and maintaining the financial health of Basic insurance. The estimated impact on customers from moving from a 20 year transition period to a 10 year transition period is less than $0.50 of the premium dollar [sic - $0.50 on the average premium].[221]

ICBC's objective of striking a balance is reasonable, and the Commission should approve the proposal.

E. CUSTOMER RENEWAL CREDIT (CRC)

119. The final element of the proposed CMP is the CRC, the inclusion of which is a legislated requirement. There are really only two issues before the Commission in this Application related to the CRC, which are (1) the MCT level that triggers the CRC and the minimum amount of the credit, and (2) whether the credit should be determined as a flat amount or in proportion with premiums paid. More detailed implementation rules will be

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[219] Chapter 4, paras. 37-43.

[220] Chapter 4, para.44.

[221] Chapter 4, para.47. The noted correction to this statement was made at T5: 699, ll.1-16.

addressed in the 2014 revenue requirements application. ICBC makes the following points on these two matters:

- First, ICBC's proposal meets the criteria specified in legislation and results in a CRC being issued in appropriate circumstances; and
- Second, the fairest way of calculating the CRC is to base it on a proportion of premiums earned, rather than a flat rate.

(a) CRC Proposal Meets Legislative Criteria and Intent

120. While perhaps not stated this way in the Application, the effect of ICBC's proposal on the CRC is that when Basic capital reaches 173% MCT or more for reasons beyond ICBC's control, all of the capital above 165% MCT will be credited to customers as a CRC. ICBC explains below why its proposal meets the criteria specified in legislation and results in a CRC being issued in appropriate circumstances.

Four Legislated Conditions Must Be Met

121. *Special Direction IC2* and the 2013 Government Directive regarding Rate Smoothing together mandate that a CRC should only be granted when four conditions are present:

- there is capital "well in excess" of the capital management target[222];
- the CRC will not result in MCT falling below the capital management target;[223]
- the Commission determines that rates will remain relatively stable and predictable despite the approval of the CRC;[224] and
- it is cost effective to implement.[225]

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[222] The wording in the Government Directive regarding Rate Smoothing imposes a more onerous requirement than *Special Direction IC2*, which refers in s.3(1)(c.3)(i) to there being "excess capital available".

[223] *Special Direction IC2*, s.3(1)(c.3)(ii).

[224] *Special Direction IC2*, s.3(1)(c.3)(iii).

[225] 2013 Government Directive regarding Rate Smoothing.

122. The phrase "well in excess" is not defined, and it falls to the Commission to determine what it means. In interpreting that provision, the Commission should have regard to the clear intent of government to make the CRC an exceptional step - a release valve in the event capital levels unexpectedly increase significantly. That intent suggests an MCT level that is appreciably higher than the new capital management target. ICBC's proposal meets these criteria.

CRC is to Deal with Unintended Capital Accumulation

123. ICBC will not set out to provide a CRC on a regular basis, as that would require first increasing rates beyond what is required to cover costs so as to overbuild capital.[226] Ms. Minogue put it this way: "The goal is not to get above 150. And the customer renewal credit is only for the circumstance where we inadvertently get above 150. So our intention is not to build capital so strongly that we're intending to turn around to give it back. That just makes no sense, to charge customers more money only to turn around and give it eventually back."[227]

124. ICBC explained that normal volatility of the insurance business, as well as requirements of the rate smoothing framework could result in fluctuations in MCT that would result in Basic capital being at 173% MCT or higher, but it is not anticipated in the immediate future.[228] Ms. Minogue explained how "you can end up with 15 percent addition to your MCT level, just in one year, from normal favourable volatility. [229]

Rationale for Only Paying Out Down to 165% MCT

125. ICBC is proposing that when a CRC is paid, that only capital in excess of 165% MCT be paid out. There is a sound rationale for not paying out all of the capital over the capital management target so as to have the credit reduce the MCT right down to 150%. Simply put, just as it "makes no sense" (to echo Ms. Minogue's words) to charge higher rates to build up

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[226] 2013.1 RR BCUC.83.2; T5: 706, l.25 to 707, l.10.

[227] T5: 714, l.20 to 715, l.2.

[228] ICBC's ability to issue a CRC is constrained in the near term in any event, due to technological limitations that are being addressed as part of the Transformation Program: 2013.1 RR BCUC.86.2. ICBC's practical approach in the unlikely event that a CRC is triggered in the intervening period is addressed in 2013.2 RR BCUC.186.1.

[229] T3: 396, ll.6-22.

capital and then pay it out as a CRC, it equally makes no sense to pay out capital as a CRC and then immediately have to collect it back from customers through higher rates. Yet, this is precisely what can happen if all capital above 150% is paid out as a CRC. Ms. Minogue explained:[230]

> …But if you were to give a customer renewal credit, and then -- okay. Give this customer renewal credit and you took it down to 150, you experience some volatility that was in the range of normal volatility, say, a 15 point hit on your MCT, drops you down even further into your rate smoothing margin, down to 135. Then you have to turn around and build capital.
>
> So that is not -- that scenario of kind of having to rebuild after immediately giving a customer renewal credit, in our interpretation, wouldn't be consistent with predict -- stable and predictable rates.

126. It would be difficult for customers to understand and accept this dynamic, particularly given the likely timing of the CRC relative to the next rate application (with the capital build provision included). ICBC is now on an annual cycle for revenue requirement applications (August 31 filings). Under that timing, the Commission would not be in a position to order a CRC until close to the end of the calendar year, if not later. It would take some time to process the CRC. By that time, the next application is only months away.

127. This undesirable "pay out then collect back" scenario is quite realistic if the Commission adopts an approach of crediting all funds over 150% MCT given the number of factors that can cause volatility in capital levels. There is, based on typical investment market experience, an approximately even chance that the investment market will fall, thus causing capital to fall below 150% and requiring the capital to be re-built.[231] 2013 RR BCUC.UT.8 provides several realistic scenarios where MCT could fall by 15 percentage points within one year's time after a CRC is activated.[232]

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[230] T5: 713, l.20 to 714, l.6. See also: T5: 778, ll.4-15 and T5: 790, l.7 to 791, l.13.

[231] T5: 790, ll.1-6.

[232] Exhibit B-29.

128. It should also be understood that the Basic MCT level reflects *unrealized* gains on investments.[233] Being too aggressive with a CRC can backfire if the markets experience a reversal. In that scenario, ICBC would be paying out a CRC based on money that it does not really have. It requires 15 percentage points of MCT (hence the proposed threshold of 165% MCT) to absorb the volatility of one standard deviation in investment returns.[234] That is, a 2% decline in the value of Basic investment assets following a CRC would drop the MCT level to 135%, effectively eliminating most of ICBC's ability to smooth rates.[235] The new tweaks to the strategic asset mix are not a silver bullet that would eliminate the risk of paying out capital down to 150%. Ms. Gould confirmed that the standard deviation of returns used by Ms. Minogue would only "go down a little bit".[236]

129. For these reasons, when a CRC is triggered, only that amount above 165% MCT should be paid out.

$25 Minimum CRC Strikes Appropriate Balance

130. The minimum amount of the CRC when paid is really a separate consideration from the issue just addressed. The proposed minimum CRC amount of $25 covers the cost associated with administering the CRC (a requirement), but also ensures that the amount is meaningful to the policyholder.[237] ICBC addressed this rationale further in its rebuttal to Mr. Landale's evidence.[238] Setting a minimum per policy requirement on the CRC amount also helps to limit the likelihood of the MCT dropping below the capital management target of 150%, because the practical result is to increase the trigger point from 165% to 173% MCT.[239]

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[233] 2013.1 RR BCUC.82.5; T5: 788, l.21 to 789, l.16.
[234] Chapter 4, para. 85.
[235] Chapter 4, para. 85, fn. 19.
[236] T7: 1164, ll.17-21.
[237] T5: 705, ll.13-22.
[238] Exhibit B-12.
[239] Chapter 4, para. 85.

(b) Equity Among Customers Achieved by Basing CRC on Percentage of Premiums

131. ICBC is proposing to calculate the CRC based on a percentage of premiums paid by policyholders, rather than a flat rate. While a flat rate may be administratively more efficient, ICBC's approach is the most fair to Basic policyholders for the reasons described in the response to 2013.1 RR BCUC.86.3. In essence, if premiums are collected proportionately, they should be returned proportionately.

PART SEVEN: IMPLEMENTATION AND CONCLUSION

A. IMPLEMENTATION

132. ICBC had initially proposed in Chapter 1, Appendix A of the Application refunding any differences between the interim rate and final rate. However, the cost of doing so is significant - approximately $2 million.[240] Given the cost, and the fact that PY 2014 will be soon upon us when the Commission Panel issues its decision, it is in the best interest of policyholders to defer the difference to the next rate application.[241]

133. The new OIC that changes the date of the next filing and future revenue requirement application filings to August 31 will likely address concerns regarding how the timing of this decision will affect the next revenue requirements application. The 2013 Government Directive regarding Rate Smoothing still contemplates, however, that the Commission will approve a CMP by May 31, 2014.[242]

B. CONCLUSION

134. ICBC submits that the proposed rate increase of 4.9% is just and reasonable in light of the expected costs of providing insurance in PY 2013 and the legislative framework. It should be approved. The new CMP also conforms with the legislative framework. It includes appropriate provisions to protect the solvency of Basic insurance as well as improve ICBC's ability to smooth rates. It should also be approved.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.

Dated: February 25, 2014

[original signed by Matthew Ghikas]
Matthew Ghikas
Legal Counsel to ICBC

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[240] 2013.2 RR BCUC.159.1 (revised January 24, 2014).

[241] T4: 649, l.22 to 650, l.7.

[242] 2013 Government Directive regarding Rate Smoothing; 2013.2 RR BCUC 157.2.