

**IN THE MATTER OF**

**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**

**Project No. 3698726**

**SUBMISSIONS OF**

**PEMBERTON INSURANCE CORPORATION**

**to the**

**BRITISH COLUMBIA UTILITIES COMMISSION**

## **SUBMISSIONS OF PEMBERTON INSURANCE CORPORATION**

### **1. Reference: Chapter 3, Actuarial Rate Level Indication Analysis**

#### **Of 'Revenue Requirements' and 'Rate Design'**

We recognize the conceptual differences between what is termed Revenue Requirements and Rate Design in the scope of utilities regulation. Revenue Requirements is about the overall, or aggregate, need to fund the costs of a utility, whilst Rate Design relates to how that total amount is divided upon, and raised from the utility's customer base.

That said, we fully comprehend the application of these concepts relative to the regulation of electricity and pipeline businesses. Those utilities incur very significant outlays for the infrastructure they build and manage, and in doing so expend large sums of money for the financial cost of capital. And for their infrastructure, they are ultimately limited to a maximum throughput capacity, and as such face seasonal or peak constraints.

In contrast, the Insurance Corporation of British Columbia faces neither a material capital outlay to conduct its business, nor is it subject to any measurable seasonal or peak constraints. Accordingly, we believe ICBC is not a utility, but is in fact simply a monopoly. ICBC is an artificial monopoly that has been created by legislation.

We say this, because we believe ICBC should be regulated not as a utility, but as a monopoly.

For ICBC, regulation is all about accounting, and not about infrastructure. With that evolves ICBC's financial statements, which are an exercise of financial construction. They reflect matters of Financial Allocation Methodology, Reserving practices, and also the myriad of loopholes relating to the "integrated" and "competitive" Optional Coverage business.

But what is of significance with ICBC, is given all the insurance accounting practices, the determination of Revenue Requirements should not be a macro process, but in fact is a matter that should be looked at as an aggregation of very identifiable and discrete components.

Those components are simple: For personal insurance, there is (1) the standard, low risk business, as well as (2) the high risk business; For commercial insurance, there are also both (3) standard and (4) high risk business, but also there is (5) the fleet business, and (6) the garage business. In the insurance industry, identifiable and discrete components of insurance are referred to as classes of insurance.

We have concerns that the standing regulatory practices of a Revenue Requirements application, like the one in progress, are biased towards treatment of ICBC as a utility, rather than as a monopoly. Unfortunately, this process glosses over these identifiable and discrete components.

We raise this issue because for the first time ever, and despite our perseverance with Information Requests and Oral Examinations over the past decade, ICBC has only now revealed much sought after statistical segmentation of their standard, low risk business.

This standard, low risk business segment is identified in the response contained in *2013.1 RR Pl.1.6 – Attachment A – Table 1 Claims Policy Statistics by CRS Level*. Specifically, the segment consists of a those 1,211,106 issued insurance policies with the Claims Rate Scale metric of level -20. But it is the loss ratio statistic of 44% that jumps off the page.

Our analysis is uncomplicated: First, there can be no argument about the fact a Revenue Requirements review for such a large number of policies (1,211,106) can be easily determined on a segmented basis; Second, on \$100 in customer paid premium, a return of \$44 in the form of claims payments, with the remaining \$56 kept by ICBC, is outrageous.

In context, to compare with the non-monopolized automobile insurance sector, again for \$100 in customer paid premium, a typical insurer would incur close to \$80 in the form of claims payments, with the remaining \$20 going towards operational cost – and the insurer would be satisfied with that return.

We believe that these captive low-risk ICBC customers are being shafted. We are also of the opinion that this practice in no way conforms to the legal requirement that rates be established that are fair, reasonable, appropriate and equitable

**We submit that not only should the application made by ICBC to impose a rate increase upon this identifiable, standard, low risk business segment be denied, but that ICBC be ordered to decrease these rates to those that are fair, reasonable, appropriate and equitable for this class as required by law.**



## 2. **Reference: Chapter 4, The New Basic Capital Management Plan for the Rate Smoothing Framework**

### **Capital Management**

Over the past decade, we have seen ICBC transformed from a not-for-profit insurer to that of one which annually generates significant revenues in excess of expenditures. This difference then accumulates as a positive surplus on its financial statements.

As an apparatus of the British Columbia provincial government, its 'parent' principal also records entries with respect to ICBC on its own books, the *Public Accounts*. On its *Consolidated Statement of Operations*, ICBC's positive return, irrespective of any cash transfers, shows as an annual incoming contribution to the provincial treasury. The other side of the account entry is on the *Consolidated Statement of Financial Position*, where the same amount is added to an account *Equity in self-supported Crown Corporations and Agencies*.

Given the Province's budgetary expenditure commitments – which are in the form of cash payments – and without a transfer from ICBC, by following the financial chain the Province must effectively borrow the amount in the form of Public Debt. Similar to most governments, the Province of British Columbia struggles to produce what is referred to as a 'balanced budget'. It is only when ICBC *makes* a cash payment transfer, borrowing is not required.

It is when the pieces of this financial puzzle are assembled, and the consolidation of integration between 'parent' (Province of British Columbia) and 'subsidiary' (ICBC), does the true capital picture becomes apparent and do our concerns escalate significantly.

This is because the capital surplus showing on ICBC's financial statements is in turn an equity investment recorded on the Province's financial statements. This equity investment is in turn constructively 100% financed by public debt. So apparent is only the illusion of ICBC capital, and the cost of this capital – interest payments to international bankers – is incurred outside ICBC's financial statements, which are instead supported by the Province.

We are of the opinion that this capital arrangement is unacceptable.

**We submit that ICBC Capital Management Plan be independent of the Government of British Columbia, and that its capital, or capital-like instruments (e.g. quota-share reinsurance) be raised directly from sources other than the provincial government. We further submit that ICBC should not be a burden to the residents and taxpayers of British Columbia, and ICBC should immediately be ordered to raise sufficient independent capital so it may fully repay the provincial treasury the equity asset carried for its value in ICBC.**



### 3. **Reference: Chapter 4, The New Basic Capital Management Plan for the Rate Smoothing Framework**

#### **Unconstitutional Taxation**

Again we state that over the past decade, we have seen ICBC transformed from a not-for-profit insurer to that of one which annually generates significant revenues in excess of expenditures.

In the world of commercial business, that difference is referred to as a 'profit'. However, this is not the case for government.

Governments are empowered to impose taxation. The most common forms are those that relate to income, sales, resource extraction, property values, or specific kinds of transactions or activities. In Canada, the power of taxation is vested in our Constitution, the *Constitution Act, 1982*.

The powers of taxation differ between the Federal, and Provincial levels of government. Whilst the Federal government can impose both direct and indirect taxes, Provincial Government are strictly empowered to impose only direct taxes. Section 92(2) states:

#### EXCLUSIVE POWERS OF PROVINCIAL LEGISLATURES

Subjects of exclusive Provincial Legislation

**92.** In each Province the Legislature may exclusively make Laws in relation to Matters coming within the Classes of Subjects next hereinafter enumerated; that is to say,

**2. Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes.**

Our concern is simple: We believe ICBC's excess of revenues to expenditures is constructively a form of indirect taxation, which is *ultra vires* to the constitution of Canada.

As such, we are of the opinion accretion to ICBC's accumulated surplus arising from the positive difference of revenues to expenditures, is illegal.

**We submit that any Capital Management Plan proposed or executed by ICBC should not, and cannot be imposed in the form as an insurance premium upon its customer ratepayer base, as any proportion permitted for capital accumulation would constitute a payment guised as indirect taxation, and this is not permissible under the Constitution Act, 1982.**



4. **Reference: Chapter 6, Claims Cost Management, Section C, Claims Cost Management Strategies**

#### Subrogation

An important operational and financial component of any insurance company is the management and value of recoveries that arise from the payment of claims. Generally, such rights of recoveries flow from the payment of property damage claims, which are then used to offset the cost of claims. These recoveries originate from either value in salvage or situations where damage was due to the negligence of another person. The process of addressing negligence, or legal responsibility, is called subrogation.

The importance of this overview of subrogation is in the interrelationship of ICBC's Basic Insurance and Optional Insurance and the financial connection.

Currently, when an ICBC adjuster acts for an Optional Coverage property damage claim, a significant part of the adjuster's role is to establish negligence of another person. So when there is both ICBC insured property damage between two cars, should the adjuster apply the facts to deem negligence on the other person, this adjuster for the property damage claim simply records this on ICBC's files, and then the claim is then conveniently converted to a Basic Insurance third party liability claim without further scrutiny.

In other words, the Basic Insurance funds are fully open to be freely exploited by the Optional Insurance claims operations.

In contrast, when an external non-ICBC adjuster acts for a non-ICBC insured property damage claim, they must present full documentation with the subrogated claim of facts and proof of negligence, and verification of amounts claimed. External access to ICBC is through a dedicated Basic Insurance subrogation unit operation. Our experience is that these subrogated claims are heavily scrutinized, subject to lengthy delays, and with settlements routinely compromised by this unit.

So there are two standards in the treatment of third party claims under the Third Party Liability Basic Insurance coverage: One which is presented by ICBC's Optional Insurance operations that is swift and without much scrutiny, and the other which is external insurers that is slow and with a great deal of scrutiny and compromise.

It is no wonder why ICBC must keep applying for Basic Insurance rate increases on one hand, and yet is able to reduce Optional Insurance rates on the other. The subrogation conduit is a massive, unregulated loophole in the payment of Basic Insurance third party liability claims to the benefit of the Optional Insurance financial cost results.

**We submit that the British Columbia Utilities Commission broaden the scope of the regulated Financial Allocation Methodology to include standardization of rules, regulations, standards, and procedures for all subrogated claims, regardless of internal or external origin, and immediately request ICBC to make application to the Commission.**



## **5. Reference: Appendix 7F, Autoplan Agency Agreement and Autoplan Distribution**

### **Appointed Agents**

We continue to be bewildered with the perverted system of insurance distribution that has evolved with ICBC's operations. We believe the system is an outdated and anomalistic business model unlike any other seen in the insurance industry.

Legislation established the notion of an 'appointed agent', which is a simple concept at face value, and has unfortunately morphed and been manipulated with creative interpretation.

Now, ICBC views an 'appointed agent' as not a service provider, but as a defacto location, or put simply a place of business. With that, the traditional role of a service providing professional insurance broker has been supplanted by retailers. With that has come retail locations as pop-ups in shopping malls, drug stores, grocery stores and other places of retail traffic. Unfortunately the effect is ICBC automobile insurance having become a low-effort, off-the-shelf product, rather than that of a meaningful financial service.

Exacerbating this distribution environment is the artificial appointment cap, or limitation ICBC imposes on the number of 'appointed agents', which has become effectively translated into the number of business locations. The negative impact is that some professional insurance brokerage firms are unable to obtain agency appointments, and on the other hand agency appointments have become intangible property – a right – which carries value like an agricultural quota or taxi licence. The current value of consideration for an appointment sale and transfer is approximately \$1,000,000, and we estimate the overall cost to the consumer for the carrying value of this right alone to be about \$135,000,000 per annum.

Beyond the surface of an agency appointment, ICBC has taken the liberty to appoint sub-agent like individuals that can access their business platform and issue insurance. We are dumbfounded as to how they have the right to do this, but these sub-agent individual appointments number in the thousands. Effectively the ICBC agency appointment system has evolved and developed into a kind a feudal system, with 'appointed agent' lords controlling the business locations and collecting the economic returns, but with serf-like individuals doing all the work of issuing the insurance.

This environment certainly begs the question as to the appropriateness of this sole channel of distribution, and it also conjures the matter of method upon basis of appointed agents remuneration. Going forward, should agents continue to be paid by ICBC on an arbitrary basis, or should each appointed agent be responsible for charging their own determined and competitively based service fee to the customers they serve?

ICBC likely has an interest to retain the current system, as many aspects of the monopolized Basic Insurance system greatly benefit aspect of their sales of Optional Insurance products. As such, we anticipate they would oppose any change.

**We submit that the distribution system is outdated, closed, and is a costly component part of ICBC's operations. We further submit that the British Columbia Utilities Commission should take action to open the ICBC distribution platform, as it would allow enterprise and innovation to flourish for the benefit of consumers.**

**Respectfully submitted**

March 6, 2014