ICBC 2015 REVENUE REQUIREMENTS APPLICATION

FINAL SUBMISSION

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MARCH 14, 2016.

With actions gamed for their effect, rather than the harder accountability that comes with transparency, the tough-minded decisiveness at the center of both good government and sound business gets subtly corrupted. Ron Suskind, Confidence Men, p.258.

I wish to thank the Commission for the opportunity to again provide my comments and recommendations regarding both the process, and certain specific proposals of the rate request. I will not repeat the historical background provided in my submission of 12 March 2015; it is on the record.

The under-estimation of FY2015 costs, and the resulting government decision to use Optional capital to restore the Basic capital reserve, are only temporary measures. The continuing growth in the cost of Bodily Injury claims in the current economic environment is not sustainable. A legislative remedy to control these costs is beyond the authority of the Commission, but it can advise the Legislature of changes that it believes are necessary in the public interest. It can also review current practices and assumptions, especially in those aspects where it still retains authority, such as an appropriate capital reserve.

The PY2015 rate request filing was delayed until 15 October 2015 to allow time to finalize the numbers after the cabinet rejected the initial 11.2 percent ($302 million) recommendation. The revised plan calls for a rate increase of 5.5 percent, and a net income deficit of approximately $160 million for FY2015. In previous submissions ICBC has maintained that rates must be based on accepted actuarial practice (AAP), where the rates must produce sufficient revenue to balance costs in the rate year, and a sufficient capital reserve is maintained. ICBC forecasts that the 5.5 percent increase will result in a FY2015 capital reserve at 108 percent.

To bolster the capital reserve, on 14 October 2015 the government ordered that $450 million in Optional policyholders' capital be transferred to the Basic program in FY2016/17, although the BCUC must assume the transfer is effective for FY2015. With the transfer, ICBC forecasts that the FY2015 MCT will be 144%. It has not indicated, however, whether the $158 million operating deficit is a one-time event or a structural shortfall. Given the recent growth in claims costs, and the size of the transfer, one must conclude that, all else being equal, the shortfall will persist in FY2016/17, requiring a further draw down of the capital reserve.

With a provincial election scheduled for May 2017, it has been suggested that the $450 million capital transfer was intended to bolster the Basic capital for both FY2015 and FY2016/17, and the setting of rates based on actual forecasted costs will be deferred to some future policy year.

1.0 RECENT GOVERNMENT CHANGES

1.1 The Fiscal Year

A change in the fiscal year can involve significant changes and requires significant lead time to manage. ICBC did not have the curtesy to advise the regulator of the Basic program of this important change prior to the information becoming public with the 16 February 2016 release of the latest service plan. Even then, it was only by reading the fine print of footnote 2 on page 15 where the change was apparent.

The lack of forewarning to the BCUC may be justified by ICBC because the Utilities Commission does not require multi-year financial forecasts of revenues, expenditures and the capital reserve. It may also explain why ICBC did not prepare a full 2015 Risk Adequacy Analysis (RAA).

The change in the fiscal year has the potential to disrupt the +40 years of the Basic data unit cost information. Will the accident year also change to maintain some comparative capability of the accident year comparisons to audited financial information? Or will future unit cost comparisons be based on the current accident year and unaudited Q3 financial information?

Recommendation:

The BCUC should require ICBC to explain how the change in the fiscal year will affect the information available for trend comparisons. The BCUC may wish to require ICBC to file key unit cost comparisons for the last 5 or 10 years using the April to March timeframe; this would include data such as cost per claim for BI and PD, and re-worked Basic financial summaries found in ICBC's annual reports.

1.2 Optional Capital Management Target

The government is amending the Insurance Corporation Act[1] to allow cabinet, rather than the ICBC board, to set the capital target for the Optional program.[2] Clearly, with the appropriation of $600 million of Optional policyholders' capital in FY2016/17 the government needed to reduce the high 260% MCT target (and one hopes the 200% regulatory minimum).

The BCUC should follow the government's example and conduct a review of the appropriateness of the current Basic capital management targets. In two of the last three rate requests (2013 and 2015) ICBC has not followed accepted actuarial practice, because the requested rate increase was insufficient to cover all operating costs, and was dependent upon a draw down of the capital reserve (a negative capital provision). Unless there is a major reduction in BI frequency or severity, it appears highly likely that the 2016 Basic rate request of 5.5% will again reduce the capital reserve.

[1] Budget Measures Implementation Act, 2016.

[2] Perhaps this is part of the government's red tape reduction initiative.

Recommendation:

In light of the recent pattern of rate requests not balancing revenues to forecasted expenditures, and guided by the government's move to reduce the Optional capital target, the BCUC should re-examine the Basic capital management target methodology and assumptions prior to the PY2016 rate submission.

2.0 THE PY 2015 RATE REQUEST

Special Direction IC 2 requires the BCUC to set the annual Basic rates based on APP, where forecasted revenues must balance to forecasted costs. For PY2015, ICBC is forecasting a 11.2% rate increase, but with the transfer of the Optional capital the net increase in rates has been reduced to 5.5%, and the forecasted net income shortfall will reduce the capital (equity) reserve. For PY2015 rate change, the government has specifically directed the Commission to disregard the requirement to set rates using APP.

Recommendation:

To conform to the revised regulation, the BCUC should approve an increase in the Basic rate of 5.5%. The Commission should also specifically approve a reduction in the capital reserve of $155 million.

3.0 CAPITAL MANAGEMENT – NEW OSFI GUIDELINES

In the 2015 rate request ICBC has advanced the novel assertion that the OSFI revised formula for calculating the capital targets should be ignored. Instead it proposes that the dollar level be retained. Because OSFI has reduced the capital reserve requirement, the effect would be an increase in the MCT target. The provincial regulation establishing the 100 percent MCT for rate setting is clear that the OSFI definition is to be used, and previous rate reviews have followed the OSFI definition for calculating the capital targets. If the BCUC were to accede to the proposal the BCUC would be increasing the capital management targets through the back door.

Recommendation:

The BCUC should reject the proposed increase in the management target and continue to use the OSFI guidelines for determining the capital reserve requirements.

4.0 CAPITAL MANAGEMENT TARGETS

ICBC did not submit a detailed review of the current capital management targets. In light of the missed forecast for PY2014 costs, and the government decision to cover the forecast FY2015 capital loss with the transfer of $450 million in Optional capital (negative capital provision), one might have expected ICBC to anticipate a series of questions respecting the capital reserve.

Leaving aside the indirect request to increase the MCT management target, ICBC asserts that the risk profile of the Basic program has not changed. To support this statement ICBC presented summary results from an incomplete 2015 risk adequacy analysis (RAA) stress test of the existing 130 MCT management target. ICBC admits that the RAA is not a Canadian Institute of Actuaries (CIA) DCAT solvency test. ICBC has not submitted a DCAT solvency analysis for over eight years.

The comparison of the RAA adverse scenario margins for 2007, 2013 and 2015 are shown below:

	Probability	Adverse Loss	Unpaid Claims	Inflation	Asset Decline	Average
2007	5 Years	109	137	121	112	120
2013	10 Years	121	120	118	133	123
2015	10 Years[3]	127	133	126	135	130

The RAA summary in the 15 October 2015 request did not contain any supporting assumptions or calculations. ICBC stated that the risk profile of the Basic insurance had not changed from 2013, yet the incomplete RAA suggests that the average of the adverse scenarios has increased. ICBC initially said that the RAA was still being finalized, but in the 29 January 2016 IR response[4] it said the 2015 RAA would not be submitted until the PY2016 rate request. Such a response to the request by the regulator for a justification of the capital management target is surprising.

ICBC stated that the information on the RAA assumptions provided through IRs "should give confidence to the BCUC and interveners to make informed decision."[5] It also asserted that the capital targets have a negligible effect on the requested 2015 rates,[6] which is only true if the management targets remain at the current levels.

In response to the BCUC's request for the assumptions supporting the four 2015 RAA adverse scenarios,[7] ICBC provided high level summaries for the asset decline and the inflation scenarios, and for the unpaid

[3] 2015 Rate Request IR1 BCUC 36.1 response.
[4] 2015 Rate Request IR2 BCUC 73.1 response.
[5] 2015 Rate Request IR2 RM 1.6 response.
[6] Ibid.
[7] 2015 Rate Request IR2 BCUC 73.2 response.

claim liability (UCL) under-estimation in another IR.[8] A review of the 2015 RAA changes in assumptions follows, which is similar to my 12 March 2015 submission respecting the 2013 RAA.

4.1 The 2015 RAA Assumptions

4.1.1 Asset Decline

The 2015 impact is up slightly from 2013; ICBC says the total stressed now includes high yield bonds, but the duration of the decline is less than in the 2013 RAA. However, the bonds replace equities, and one would expect a decline in the bonds to be much less severe than the equities. ICBC applied a 14.6% stress on the equities and a 13.4% stress on the high yield bonds. ICBC stated that the change from equities to high yield bonds resulted in a slight decline in the adverse scenario impact,[9] but this is not evident in the summary number. The new OSFI MCT guidelines place a higher risk factor on equities which will be phased into the new 100% minimum target level.

ICBC’s 2014 Annual Report states that a 10% decline in equity prices results in a $260 million loss in OCI; assuming 65% are related to Basic, the $170 million Basic loss amounts to a 14-point loss in the MCT, and a 15% loss would equate to a 21-point decline compared to the RAA impact of 35 points.

The high yield bonds are US corporate (approximately $700 million in below BBB grade).[10] It is impossible to determine if ICBC has included the favourable benefit from the exchange rate in its calculations.

Without the detailed assumptions and calculations, it is impossible to take confidence in the 2015 RAA information presented.

4.1.2 Inflation

The 2015 impact is now 126, or up 6.8 percent from 2013, despite ICBC reducing the duration of the increase from 4 to 3 years. The assumed rise in the interest rate (discount rate) has not changed from the asymmetric assumption used in 2013. In its sensitivity analysis, Intact Financial estimated that a 1 percent increase in inflation would lower its MCT by 3 points, as the discount rate on unpaid claims would increase.[11] In its 2014 annual report, ICBC states that a “natural hedge’ exists between the fixed income portfolio and the provision for unpaid claims. Through duration matching of bond assets to the claim liabilities, most of the impact of inflation is offset by an equivalent increase in the discount rate on unpaid claims.[12] In its Q3 2015 report the Saskatchewan Auto Fund notes that while interest rate increases reduce

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[8] 2015 Rate Request IR2 RM 1.9 response.
[9] 2015 Rate Request IR 1 BCUC 36.15 response.
[10] ICBC 2014 Annual Report, p. 57/58.
[11] Intact Financial Annual Report 2015.
[12] ICBC Annual Report 2014, p. 57.

the fair value of the investment portfolio, there is also an increase in the discount rate on claim liabilities, "resulting in a relatively neutral effect on the Auto Fund as a whole."[13]

In the Manitoba Public Insurance Basic 2015 DCAT analysis, used to justify the 100% capital management target, there was no inflation adverse scenario. The MPI chief actuary said that given the stability of inflation forecasted for the immediate future, such a scenario was no longer viable.[14]

Without the detailed assumptions and calculations, it is impossible to take confidence in the 2015 RAA information presented.

4.1.3 Loss Cost:

The 2015 RAA impact is up 6 points, or about 5%, from the 2013 RAA. Given the under-estimation in recent years of the average cost, one might assume that this is reflected in the rise in impact of this scenario. But no assumptions were provided. If the increase relates to annual inflation and policy growth this should be provided for in the capital maintenance factor. There appears to be a linkage between this factor and the provision for adverse deviation which needs to be explained more fully.

Without the detailed assumptions and calculations, it is impossible to take confidence in the 2015 RAA information presented.

4.1.4 Unpaid Claims:

The 2015 RAA impact is 133, or some 10.8% greater than the 2013 RAA impact. ICBC says this reflects a 16% growth in the value of the UCL from 2013 to 2015 (using ICBC's UCL forecast of $6.82 billion for FY2015 the increase is 19.2%).[15] ICBC includes a factor for capital maintenance in the rate request, which is designed to have the capital reserve grow in relation to annual policy growth and inflation. One would think that some of the growth in this scenario would be accommodated in this maintenance factor. However, the rapid growth in the UCL is a serious concern, as the OSFI risk factor and the BCUC management target, produce a compounding effect on the need for additional capital as the UCL grows.

Without the detailed assumptions and calculations, it is impossible to take confidence in the 2015 RAA information presented.

Recommendation

The BCUC should place no reliance on the summary 2015 RAA information. The 2013 RAA was also devoid of supporting data. The capital reserve targets are overly conservative.

[13] Saskatchewan Auto Fund, "Quarterly Report, September 2015", p. 4.
[14] Manitoba Public Utilities Board, MPI 2016/17 Rate Request, Transcripts 15 October 2015, p.1316.
[15] 2015 Rate Request IR1 RM 3 response.

5.0 REVIEW THE CAPITAL TARGETS

With hindsight, the PY2014 rate forecast was seriously wrong, requiring a PY2015 rate increase of some $300 million, or 11.2%. On 14 October 2015, the provincial government ordered that $450 million in Optional policyholders' capital be transferred to the Basic program to restore the capital reserve and allow a rate increase of only 5.5% for PY2015. Optional rates rose 2.2% on 1 November 2015.

The $450 million was the third injection of Optional capital to the Basic program since FY2011, with the cumulative total now $935.7 million (the 2011 MCT was 147%, and the forecast for 2015 is 144%). On a steady state basis, the Basic program appears to now have a structural deficit of approximately $160 million. If this is not addressed the capital reserve will decline by some $320 million in the next two periods.[16]

In my 12 March 2015 submission, I recommended that the BCUC focus on the capital management targets and reduce the MCT management target to 100%. The Commission saw no reason to revisit the targets.[17]

In the first round of IRs in the current rate review, the BCUC asked ICBC whether, given all the changes affecting the capital reserve since 2008, the underlying assumptions of the capital management plan and the RAA should be reviewed. Not surprisingly, ICBC replied that a review was not required. If, in ICBC's opinion, circumstances changed then it would bring any proposed changes forward as part of the annual rate review process.[18]

In the first round of information request responses ICBC was again confusing the RAA target stress test with the CIA DCAT methodology which tests solvency. It advised the BCUC that the RAA was the same as DCAT, then later said the RAA methodology was "guided by" the DCAT methodology.[19] In the second round of information requests ICBC confirmed that the DCAT tests solvency.[20] ICBC believes that testing for solvency is not relevant because SD IC2 requires the BCUC to **set rates** such that the 100% MCT minimum will be maintained. The regulation does not require that the MCT must be maintained **at all times**. The capital plan provides a mechanism to rebuild the capital if the MCT drops below a desired level.

The BCUC should take the initiative on this important issue and schedule a through review of the current targets, and the capital management plan in general. ICBC should contract with actuaries experienced in public auto insurance risk assessment. As I suggested last year, the early stages of the adoption of the

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[16] The phase-in of the new OSFI guidelines will moderate the decline in the MCT, as assets formerly required to support the 100% regulatory target can be redeployed.

[17] 2014 Rate Request, BCUC Decision of 19 May 2015.

[18] 2015 Rate Request, IR1 BCUC 36.17 and 36.18 response.

[19] 2015 Rate Request, IR1 BCUC 36.12 response. ICBC also said the RAA was updated every year, see IR1 BCUC 36.11 response.

[20] 2015 Rate Request. IR2 RM 1.1 response.

OSFI guidelines were marked by uncertainty about terminology, and the differences between a public monopoly and investor owned P&C insurers operating in a competitive market.[21]

The BCUC should take advantage of the review of the appropriate Basic capital reserve management target undertaken by the Manitoba Public Utilities Board. In December 2015, after a lengthy and detailed review of the OSFI MCT approach to establishing the appropriate capital-setting methodology, the Board approved a Basic capital management target of 100%, with the PY2016 target at 85%.[22] Appendix 1 contains more information on the difference between the ICBC approach to justifying the current capital management target, and the DCAT solvency-based approach used by Manitoba Public Insurance. Given that the RAA uses a 1 in 10 years (90th percentile) probability, compared to the MPI/DCAT using 1 in 40 years (97.5th percentile), the difference in MCT margin suggests that the ICBC margin is too conservative.

Recommendation

The BCUC should schedule a separate proceeding to review the capital management plan assumptions. Prior to the review, ICBC should file a complete DCAT (solvency) and RAA based on the FY2015 results (including the $450 million). Using the same format as the IR1, RM 3 response, the package should include the financial results for FY2015, and forecasts for FY2016/17 and FY2017/18. All key assumptions used to develop the forecasts should be documented and included with the submission.

6.0 CLAIMS PROCESSING AND BACKLOGS

The continuing growth in the number and average cost of BI claims continues to be the main driver of Basic program costs and rates, and threaten the sustainability of the full tort model. The significant rate increases of recent years, highlighted by the forecasted 11.2 percent increase for PY2015, indicate that a new approach may be required. ICBC has launched media campaigns to encourage safer driving and earlier settlements to try to reduce the number of claims. Currently it has media spots suggesting that fraud is prevalent, costing policyholders some $100 per year.

ICBC has not proposed any significant program to speed the settlement of claims. Such an initiative may actually encourage more claims (through lower adjudication standards), but the existing BI claim processing capacity has been insufficient, resulting in a growing backlog of claims and a significant increase in the annual UCL cost.

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[21] 2014 Rate Request, Richard McCandless "Final Arguments," 12 March 2015, Chapter 3.

[22] Manitoba Public Utilities Board, MPI 2016/17 Rate Request, Decision of 1 December 2015. The MPI rate review included and interesting, if sometimes confusing, discussion between Luke Johnston, MPI's chief actuary, and Andrea Sherry, currently Wawanesa Mutual's chief actuary, on the appropriate size of the capital reserve for a Crown insurer. http://www.pub.gov.mb.ca/pdf/transcripts/mpi/2015/mpi_gra_oct_15_2015.pdf

From FY2010 to FY2015[23], the provision for current year claims, including adjustments for prior years, has increased from $1.78 billion to $2.72 billion, an increase of 52.8%, or 10.6% per year. During the same period the earned revenue has grown by $585 million, an increase of 28 percent, or 5.6% per year. The difference has been funded by the capital reserve, which has been replenished by $485 million in Optional capital transfers in 2012 and 2013, and a further government-ordered infusion in October 2015.

As discussed in my 12 March 2015 submission[24], the growth in the UCL -- $2.24 billion since 2010 – adds to the pressure on rates because of the OSFI risk factor. This growth in the UCL has required some $200 million in additional assets to maintain the MCT in the 145 to 150% range. It is not possible to calculate the net impact of the new OSFI MCT guidelines on the provision for unpaid claims as ICBC has not supplied a detailed RAA.

Between 2010 and 2015, ICBC has reduced bargaining unit FTEs in conjunction with its new information systems and business processes. Most of these positions were in the claims processing group. The annual FTE reductions are shown in Table 1, together with the number of BI claims closed and pending (000s). The increase in Basic UCL (in millions) is also shown.

TABLE 1. FTE REDUCTIONS AND CLAIMS (000s)

	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015f
FTE Change	(48)	(25)	(114)	(129)	60	(61)
BI Claims Closed	42.4	40.0	39.0	41.1	41.8	N/A
BI Claims Pending	51.5	54.6	59.1	60.8	63.4	N/A
UCL Increase $/M	109	244	468	431	523	575

Source: ICBC 2015 RR of 15 October 2015, p. 4-15, and 2013 RR Exhibit A2-15; claims from 2015 RR, IR RM 1.0 response. ICBC provided a data series of claim exposures, but the trend is essentially the same as claims.

The FTE reductions impact both the Basic and Optional claims processing capacity, but as some 80 percent of the UCL is attributable to Basic it is assumed that a similar workload measure applies to the FTEs.

Table 2 shows the funding capacity of the UCL by program, and compares the ratios to that of Intact Financial. The ratio is the annual UCL divided by the earned revenue

[23] 2015 Rate Request, IR1 RM 3 response.

[24] http://www.bcuc.com/Documents/Arguments/2015/DOC_43293_03-12-2015_McCandless_Final-Argument.pdf

TABLE 2. RATIO OF UCL TO EARNED REVENUE

	FY2010	FY2011	FY2012	FY2013	FY2014
ICBC BASIC	218	231	240	243	253
OPTIONAL	99	104	103	110	114
CORPORATE	166	174	181	189	196
INTACT FINANCIAL	104	141	117	113	110

Source: Annual Reports. The 2011 data for Intact Financial reflects a corporate acquisition.

Of course Intact Financial is not subject to the full tort liability cost for BI claims faced by ICBC. The table does, however, show the five-year trend in the capacity (earned income) to fund the UCL cost. ICBC has not been investing enough in its claim processing capacity.

ICBC has provided multiple assurances that the rise in the BI claim backlog is a temporary measure which will be resolved as the new IT and business systems stabilize. Yet each year the BI claim processing backlog grows. It is time to take more direct action to not only stop the increase in UCL costs, but to actually reduce the size of the UCL for Basic insurance.

Recommendation

The BCUC should require ICBC to submit a plan, including a full cost/benefit analysis, to increase BI claim processing capacity and reduce the Basic UCL by increments of $500 million over three years.

Such a reduction in the UCL may not be acceptable to the government as it could, all else being equal, result in a negative net income for Basic, and a reduction in net assets. The benefit to policyholders is a reduction in balance sheet liabilities for the same rate level.

7.0 PROCESS AND REPORTING

7.1 Multiple Fiscal Year Forecasts

Setting Basic rates within the current one-year time horizon has only limited usefulness. The regulatory capital target requirements are based on the fiscal year, and changes in rates impact the net income and capital levels for at least two fiscal periods. The BCUC needs to see the multi-year fiscal year implications of various rate options. ICBC says that to provide multi-year forecasts would be unreasonable, and may confuse customers if the indicated rate changes based on more recent information.[25] Yet it prepares a three-year forecast for the annual service plan, which is included with the

[25] 2015 Rate Request, IR2 TREAD 26.5-6, and 29.1 responses.

government budget forecast. The corporate forecast is built from the Basic and Optional forecasts, so the real answer may be that accountability can be dangerous, resulting in unwelcome questions.

Can ICBC's 2016/17 to 2018/19 service plan be used to infer a forecast for Basic insurance costs and revenue? The inclusion of Optional insurance, and the change in the fiscal year, complicates comparisons with the Basic information available. The service plan forecasts a significant revenue increase over the next two years (up 15% from FY2015 to FY 2017/18). Net claims incurred are increase only marginally during the same period. Given the Basic claim cost increases recorded during the last two or three years, the service plan forecast appears highly unrealistic (unless the government has some legislative change planned to arrest the growth in the BI claims cost). The ICBC plan assumes an unspecified rate increase.[26]

Appendix 2 is a simple forecast for the January-December fiscal period based on the assumptions in the government budget documents and ICBC's February 2016 service plan. With the assumptions provided, the Basic program will fall below the 100% MCT level during 2017 (or FY2017/18 in the new model). An approximate rate increase of 12% would be required in FY2016 to balance the net income and maintain the MCT (less the loss to the MCT caused by the growth in the UCL, partially off-set by the benefit of the new OSFI guidelines). If the 12% was approved, the FY2017 indicated rate increase would be approximately 2% (the MCT would continue to decline with the growth in the UCL).

Alternatively, by lowering the capital management target to 110% no increase in rates would be required for FY2016, and an approximate 10% would be required for FY2017. Such a course of action is precluded by the government price controls, which will require a minimum 4% rise for FY2016 if the current rate request is approved (or 10.7% if the 2015 rate increase is based on AAP).

Recommendation

The BCUC should require ICBC to submit current fiscal year and two future fiscal year forecasts with each revenue requirement application. The format should be guided by the format in ICBC's response to IR1 RM 3.

7.2 Separate Operating and Capital Approvals

Section 5.3 of my 12 March 2015 submission discusses this point. The October 2015 transfer of Optional capital reinforces the earlier recommendation that the capital should be approved and tracked separately from the operating forecasts. Ignoring the price controls for the moment, the BCUC is constrained by the break-even revenue and expenditure requirement for operations, and the 100% MCT requirement for capital. Separating the issues lessens areas of potential confusion compared to the current combined approach.

[26] ICBC, 2016/17 – 2018/19 Service Plan, February 2016, p. 15.

Recommendation

Separate operating and capital approvals when approving annual rate changes.

7.3 Change The Policy Year

Prior to the most recent change the policy year followed the fiscal year-end by one month. For reasons unknown (but likely related to the 2013 election) the year was changed to start on November. ICBC based the new year rate change on Q1 (end of March) cost forecasts. With the fiscal year shift the forecasts, if still based on Q1 (end of June), will constrict the time ICBC has to analyze the data. The November start of the policy year means the audited financials will be 7 months "stale" and the forecast for the current year will be 5 months in advance of year-end.

The Commission may wish to make a recommendation to the government to re-align the policy year, perhaps to June 1st, to have firmer base year audited financial data.

7.4 Improved Reporting

The Commission (to my knowledge) and the public receive no quarterly reports on Basic finances. There is a single page financial summary included in ICBC's annual report, but no meaningful disclosure of performance, or management discussion section reviewing operational issues related to the Basic program. ICBC says this level of reporting meets the government minimum requirement, and details are provided during the annual rate request.

Given that ICBC is an important Crown corporation, the fact that vehicle owners are compelled to purchase ICBC's Basic insurance, and the growing cost of that insurance, the current level of reporting and disclosure is clearly inadequate.

In my 12 March 2015 submission (section 5.4), I requested the BCUC to adopt the best practices of the reporting systems in place in Saskatchewan and Manitoba for their compulsory insurance. I repeat that request.

8.0 AFFORDABILITY

From 2010 to 2014, Basic rates have risen by a cumulative 17.8%, compared to a cumulative CPI increase of some 5.1%. During the same period, the number of net written personal policies has grown by 6.1%. The growth in the average rate, combined with the growth in policies, does not automatically translate into an equivalent growth in ICBC's Basic policy income. Older and more experienced drivers enjoy lower rates compared to younger and less experienced drivers. Policyholders aged 65 and older receive a 25% discount if classified as pleasure. These factors can reduce the average revenue per policy as the average age of policyholders increases.

From 2010 to 2014, the number of net exposures of those 65 and older has grown by 23%, while the net exposures of those aged 24 and under has remained flat (up 0.4%).[27] If this trend continues, or accelerates with the "greying' of the population, ICBC will require even more revenue per policy to maintain the same level of income.

The growth in the cost of Basic insurance may becoming a barrier to young potential vehicle owners. The ageing of the policyholder base is also a longer-term concern for the current public insurance scheme. The affordability of continuing the senior discount should be considered. I estimate that this subsidy represents an inter-generational transfer of approximately $50 million per year. The elimination of the senior free pass by the BC Ferries Corporation may be instructive.

RMcC

14 March 2016

[27] 2015 Rate Request, IR 2, RM 4.2-3 response.

APPENDIX 1

COMPARISON OF ICBC 2015 (PARTIAL) RAA ADVERSE MCT MARGINS TO

MPI 2015 DCAT ADVERSE MARGINS

ICBC 2015 RAA

- 1 in 10-year probability (90th)
- Revision to 2013 RAA, where no detailed assumptions or calculations provided (such as time frames, base scenario or management/regulator actions

MPI 2015 DCAT

- Full DCAT report as of September 2015
- 1 in 40-year probability (97.5^{th})
- Excludes inflation adverse scenario, but includes a combined adverse scenario

IMPACT OF CHANGE IN MCT PERCENTAGE (worst year)

	ICBC(90th)	MPI(97.5^{th})
Asset Decline	(35.0)	(42.5)
Loss Cost	(27.0)	(31.2)
Unpaid Claim/Interest Rate Decline	(33.0)	(32.2)
Inflation	(26.0)	Not Relevant

Source: 2015 Rate Request, IR 1 BCUC 36.12-14 response, and Manitoba PUB, MPI 2016/17 Rate Request Vol 11, 2015 DCAT Report of September 2015.

	ICBC	MPI	Sask. Auto Fund
FY2015 MCT[28]	144	85 (2015/16)	88 (Q3 2015)
Management Target MCT	130/145	100	100

Source: ICBC from 2015 Rate Request, IR 1 RM 3; MPI from 2016/17 Rate Request; Saskatchewan Auto Fund from 3rd Quarter Report 2015.

The RAA approach has a higher probability level for adverse events, compared with the DCAT which tests the base scenario and various adverse scenarios at a lower probability. Given that higher probabilities generally require less severe scenarios, it is surprising that the results from the RAA are not much lower than those produced by the MPI DCAT report; in fact, the unpaid claims/interest rate results are about equal. The fact that ICBC operates in a tort environment may be a factor, but the DCAT methodology should apply the same adverse scenarios. The size of ICBC's Basic UCL may also be a factor, but this has not been raised as an issue by ICBC, as it rarely discusses this $6.8 billion item.

A high rate stabilization reserve can encourage a form of moral hazard at the management level. It was originally justified to protect policyholders from rate increases made necessary by unexpected events or factors, especially the volatility in investment values and underwriting, but is also being used to absorb variances in annual budget forecasts. This can lead to a weakened management focus on cost control, such as the growth in unpaid claims, and cost forecasting.

A high capital reserve is a form of forced savings (or insurance) for Basic policyholders, and raises questions as to the opportunity cost of where best this money can assist policyholders and the provincial economy. ICBC has proposed that the investment income from the reserve helps keep rates lower, but if the excess capital (that above the 100% level) is held in the form of higher risk equities, the OSFI discount factor of 20% can require a higher amount of funds to achieve an MCT above the 100% target (held in the form of fixed assets).

It would be useful to see a solvency-based DCAT report on ICBC's Basic insurance, using the FY2015 actuals including the $450 million capital transferred from the Optional program.

[28] Includes $450 million from Optional ICBC and $75 million from Extension MPI

APPENDIX 2

TABLE 1 RMcC FORECAST FOR BASIC ($=millions)

(no adjustment for new fiscal year)

	FY2015	FY2016	FY2017
Earned Policies (000s)	3,132	3,188	3,240
Rate Increases	5.5%	--	--
REVENUE-Earned	2,681	2,840	2,870
-Investment	569	300	300
EXPENSES-Claims	2,549	2,750	2,890
-Prior Yr.	168	50	--
Prem. Tax&Com	226	250	255
Other	336	350	360
Non-Insurance	129	130	130
Total	3,408	3,530	3.635
NET INCOME	(158)	(390)	(465)
OCE	26	--	--
EQUITY	1,793	1,403	938
MCT	144	112	73
Unearned Prem.	1,284	1,350	1,370
Unpaid Claims	6,820	7,400	7,900

ASSUMPTIONS:

Policy growth -- from BC government Budget and Fiscal Plan 2016/17 p. 119.

Earned Premium	2016=2015 rate increase of 5.5% for 10 months X 1.8% veh. growth X (0.3) Aver. $.
	2017=2016 X 1.7% vehicle growth X (0.3) Average $
Claim Cost	2016=2015 X 8% (average 2010 to 2015) less $50M for frequency reduction.
	2017=2016 X 5% (some moderation in growth).
Prior Year	guided by ICBC Service Plan 2016/17.
Invest. Income	guided by ICBC Service Plan 2016/17.
MCT	2015 $12.5M = 1%
	2016 $1,403/12.9 = 109, growth in Unearned Premiums and UCL adds approximately $43 million to 100% requirement, plus 3 MCT for new OSFI guidelines.
	2017 $938/13.3 =70, growth in Unearned premiums and UCL adds approximately $35 million to 100% requirement, plus 3 MCT for new OSFI guidelines.

Under this scenario, without a price increase in November 201, the MCT drops to 112% in FY2016, and 73% in FY2017. Part of the shortfall is the FY2015 loss in net income carried forward, and continued growth in the average cost of claims. The reduction in investment income in FY2106 also increases the net income shortfall.

No assumption is made for further Optional capital transfers the Basic, as the Optional capital reserve is at or below the minimum requirement.