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**VIA EMAIL**

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**ICBC 2013 REVENUE REQUIREMENTS EXHIBIT A2-10**

Ms. June Elder  
Manager, Corporate Regulatory Affairs  
Insurance Corporation of British Columbia  
151 West Esplanade  
North Vancouver, BC V7M 3H9

Dear Ms. Elder:

Re: Insurance Corporation of British Columbia  
Order G-141-13/Project No. 3698726  
2013 Revenue Requirements Application

Commission staff submit the following document for the record in this proceeding:

Politics and Public Automobile Insurance in BC 1970-2010 R. McCandless.

Yours truly,

Erica Hamilton

/kbb

Enclosure

cc: Registered Interveners  
(ICBC-2013RR-RI)

# POLITICS AND PUBLIC AUTOMOBILE INSURANCE IN BRITISH COLUMBIA, 1970–2010

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RICHARD C. MCCANDLESS

## INTRODUCTION

**A**UTOMOBILE INSURANCE encompasses many important aspects of living in a modern society. These include legal practices, medical services, customer relationships, community involvement, and management theory. This review focuses on (1) the evolving political and financial relationship between the publicly owned Insurance Corporation of British Columbia (ICBC) and provincial governments of various political philosophies over the four decades of its existence and (2) how ICBC was often shaped by, and sometimes itself influenced, the politics of British Columbia. Today's public auto insurance retains some of the original ideals of not allowing private corporations to profit from individual physical and financial loss resulting from automobile crashes. Yet it no longer attempts to provide low-cost auto insurance; rather, it more closely resembles a commercial operation providing profit for the government. Direct government control over rates has been replaced by indirect control through an intermediary body and cabinet orders. Despite attempts to depoliticize control over ICBC, especially with regard to the setting of annual premiums, the current government has in many ways actually increased its control of ICBC and has significantly altered its objective of providing low-cost insurance.

## THE EARLY YEARS

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In the late 1960s, high public dissatisfaction with the state of automobile insurance, particularly rising rates and poor service, led the Social Credit government of W.A.C. Bennett to establish a royal commission, chaired by Justice Robert Wootton of the Supreme Court of British Columbia, to review the situation. The commission's report, completed

in July 1968, concluded that there was no effective competition in prices and that a significant number of uninsured drivers were on the road. It recommended that the government take over the sole selling of auto insurance if the industry failed to adopt his recommendations, such as adopting a no-fault system of claim resolution.<sup>1</sup>

The Social Credit government responded in 1969 by requiring all vehicle owners to purchase a minimum of \$50,000 in liability insurance to ensure that benefits would be paid for personal injury or death, regardless of fault. The opposition New Democratic Party (NDP) had long advocated a government-owned insurance corporation based on the experience of the government-owned insurance corporations established by NDP governments in Saskatchewan and Manitoba. The introduction of compulsory insurance strengthened the NDP's support for a public auto insurance system. The NDP believed that auto insurance was a public good that should be provided on a break-even basis and that a government plan would create an investment fund that would provide capital for financing capital projects within the province.

Many Social Credit supporters also favoured a publicly owned insurance corporation. The 1971 Social Credit convention debated a resolution supporting a government insurance system but referred it for future study to Attorney General Leslie Peterson. Peterson's admission that he was not happy with the compulsory non-fault system prompted the *Vancouver Sun* to editorialize that the objective of the government should be to provide British Columbia with a scheme that results in the best and cheapest auto insurance coverage:<sup>2</sup>

Is the multiplicity of private profit seeking insurance carriers, as opposed to a single non-profit government vendor, operating to the severe disadvantage of insurance buyers? Is there any real government knowledge of, let alone control of, profits in this industry so happily forced by government decree, as the cost of premiums continue to go up and up? ... Mr. Peterson was wise to save his usual snow job for more credulous listeners.<sup>3</sup>

In the campaign preceding the September 1972 general election the NDP made government auto insurance a major part of its platform and promised that rates would be no higher and perhaps lower than those charged by private companies. Anxious to fulfill its election promises,

<sup>1</sup> Insurance Corporation of British Columbia Annual Report (hereafter ICBC Annual Report), 1987.

<sup>2</sup> *Vancouver Sun*, 6 November 1971.

<sup>3</sup> *Ibid.*, 22 November 1971.

the new NDP government, led by Premier Dave Barrett, gave Transport Minister Robert Strachan the responsibility of setting up the new entity that would deal with both auto and general insurance. Its priority was underlined by the fact that the authorizing legislation was the second bill introduced in the new government's first session.<sup>4</sup> The government's insistence on having the corporation running by 1 March 1974 resulted in many implementation problems, but the biggest mistake was keeping the insurance rates at the level of those in effect in 1972.

Few government services directly affect as broad a group of voters as does automobile insurance. Increasing reports of start-up problems, a confusing rate system, the perception of poor service, and a general bias against public ownership on the part of a segment of the population led to concern that the government insurance corporation was not providing the promised benefits. ICBC quickly became a political liability. As Premier Barrett commented ten months after ICBC was introduced: "You can do all kinds of things and the people won't get upset, but raise or tinker with their auto insurance and you'll get more complaints than you can handle. I've received more letters complaining about ICBC than all the others put together."<sup>5</sup>

As a result of the oil crisis of 1974, gasoline prices rapidly increased, as did the government revenue from fuel taxes. Motorists wanted lower prices and pressed for lower taxes, but the NDP government saw the extra revenue as a way of subsidizing the losses ICBC was incurring because it had not raised premiums for 1975 – this despite a \$34.5 million loss in its first year.<sup>6</sup> In the legislature, opposition members complained that drivers in rural areas would bear a disproportionate amount of the proposed subsidy since they drove further, on average, than did urban drivers. Others contended that subsidizing auto insurance from general revenue would make it more difficult to ensure ICBC's accountability. As Hugh Curtis (a Conservative MLA who would soon join the rebuilding Social Credit Party) said:

The introduction of a subsidy in ICBC is going to sufficiently cloud the financial failure of Autoplan [ICBC] that we will never be in a position

<sup>4</sup> British Columbia, Debates of the Legislative Assembly (hereafter *Hansard*), 25 January 1973.

<sup>5</sup> Lorne J. Kaevic and Garry Brian Nixon, *The 1200 Days – A Shattered Dream: Dave Barrett and the NDP in BC, 1972–75* (Coquitlam, BC: Kaen Publishers, 1978), 139. See also Geoff Meggs and Rod Mickleburgh, *The Art of the Impossible: Dave Barrett and the NDP in Power, 1972–1975* (Madeira Park, BC: Harbour, 2012).

<sup>6</sup> ICBC Annual Report, 1975. For a more detailed review of the establishment of ICBC, see: Jason D. Wallace, "Public Liability Insurance Regulation and the Creation of the Insurance Corporation of British Columbia" (MA thesis: University of Victoria, 2006).

to sort it out. Public Accounts notwithstanding, we will not be able to recognize actual costs of insuring automobiles in British Columbia, because it's going to be operated with one hand in the Autoplan purse and the other hand in the consolidated revenue purse.<sup>7</sup>

By the fall of 1975, the Barrett government realized that a serious financial situation was developing at ICBC. In November, ICBC warned the government that it expected a shortfall of \$181 million and that it was rapidly diminishing its operating cash (in the early years annual policies were paid on 1 March each year). Despite attempts at cost control and a federal wage restraint scheme, rising claims and health costs were pushing ICBC further into the red.<sup>8</sup> Premier Barrett called a surprise election for 11 December 1975. William (Bill) Bennett, who led a reinvigorated Social Credit Party to election victory, believed that Barrett called the election when he did because the looming loss "was so beyond them [the NDP] that they called an election out of fear of the true facts of that corporation being made public before the public would have the chance to assess them on their record and wipe them out forever."<sup>9</sup>

During the election Bennett was vague about the future of ICBC, other than maintaining that it should compete with private insurance companies and not receive government subsidies. His government included a number of former Liberal and Conservative MLAs. He made Pat McGeer, the education minister and former Liberal MLA, responsible for the corporation. The new government dismissed the NDP-appointed board of directors of ICBC, but ICBC's financial situation gave the government little time to develop a coherent plan for the future.

Normally, ICBC announced its rates for the forthcoming year before the end of December, but the election had intervened. The Barrett government had not taken any action on ICBC's request to raise rates by 19 percent, assuming the proposed fuel tax subsidy. A report prepared for the new government by Byron Straight, a respected Vancouver insurance accountant, said that a 19 percent rate increase would require an annual tax subsidy of \$125 million. Without the subsidy, it would be necessary to increase rates by approximately 140 percent to meet the forecast expenditures and to eliminate the prior accumulated losses by March 1976. The real significance of Straight's report concerned his recommendation that there be a clearer separation between ICBC and the government. He also proposed that ICBC should continue its monopoly

<sup>7</sup> *Hansard*, 3 June 1974, 3667. The legislation was not proclaimed.

<sup>8</sup> *Ibid.*, 19 March 1976, 66-69.

<sup>9</sup> *Ibid.*, 26 July 1977, 4065.

on the sale of compulsory third-party liability insurance (then set at \$50,000) while both ICBC and private firms could compete for property insurance and third-party liability in excess of the minimum (now known as optional insurance). He also criticized ICBC's lack of effort in reducing the number and cost of claims.<sup>10</sup>

The government rejected the proposed subsidy and announced a massive increase in auto insurance rates on 2 January 1976 for the premiums that were due at the end of February. This sparked a public outcry against the increase. Public demonstrations were organized, over 250,000 individuals signed a protest petition, and a number of newly elected Social Credit MLAs publicly criticized the decision.<sup>11</sup> Opponents of the huge increases suggested that the new government was punishing voters for electing the NDP and providing the private insurance industry with a more profitable market for optional insurance.

An embattled Pat McGeer became the focus of the protest. After stating that those who could not afford the insurance should sell their cars, he left for a Hawaiian vacation.<sup>12</sup> The protest chants of "Stick it in your ear, McGeer" became common, and the ICBC minister was hung in effigy. The government bowed to the pressure by announcing a smaller rate increase designed to balance the 1976-77 expenditure and by providing a one-time grant of \$181.5 million to pay off the debt of the prior years. This was a significant amount; it was approximately 70 percent of the total government deficit in 1975-76 and 1.5 times the total government expenditure on the justice system in that year. The grant was made in the last week of the 1975-76 fiscal year and, along with other year-end payments to various agencies, helped the government to claim that the NDP had mismanaged the provincial finances.<sup>13</sup>

#### ICBC AND SOCIAL CREDIT

The \$181.5 million grant, together with the significant rate increase for 1976-77, stabilized ICBC's finances. By 28 February 1977, it reported a surplus of \$15.6 million even after committing \$52.3 million to a safe driver rate discount program. In its annual report ICBC admitted that higher rates contributed to a 40 percent drop in the number of claims by "creating a renewed awareness of the ever growing cost of automobile

<sup>10</sup> *Vancouver Sun*, 6 January 1976.

<sup>11</sup> *Ibid.*

<sup>12</sup> *Vancouver Sun*, 3 January 1976.

<sup>13</sup> *Hansard*, 17 February 1977, 1069.

accidents” and thus promoting safer driving.<sup>14</sup> The safe driver discount also reduced the furor over the rate increase. Most stakeholder groups supported the corporation, especially the independent sales brokers who had persuaded the government to reject ICBC’s proposal to reduce costs by accepting renewals by mail.<sup>15</sup> Not all the stakeholders were happy. Private insurers had been lobbying the government to allow them to compete for the basic liability business. McGeer was not sympathetic. He asserted that he was a long-time believer in socialized automobile insurance and called the private insurers who wanted to abolish ICBC “dumb.”<sup>16</sup> Only one private insurer had begun selling optional policies to low-risk drivers, but, despite higher commissions for agents, members of the public generally preferred the convenience of bundling their insurance with ICBC.<sup>17</sup>

In September 1977, McGeer announced changes designed to depoliticize the management of auto insurance by authorizing the board of directors of ICBC to set optional rates and to appoint sales agents without cabinet approval. Private insurers would be encouraged to return to the province to compete for the optional auto business, and ICBC would institute a staggered renewal system that mirrored that of the private sector. This would end the annual February rush to renew licences and provide ICBC with a better cash flow.<sup>18</sup> The government cited the lack of prior warning of ICBC’s financial position in order to support major reforms in its (the government’s) administration, including quarterly financial reports, improved financial standards and controls, and the creation of a legislative committee to monitor the performance of Crown corporations.

While McGeer claimed that he was depoliticizing ICBC, the government continued to appoint the board of directors, and McGeer remained as chair of its board. Significantly, the government, rather than the ICBC board, announced that it had directed ICBC to implement a scheme whereby rates would better reflect the individual risk, as compared to establishing risk based on groups. The new plan would provide for a gradual increase in rates (or a loss of discount) for higher-risk drivers based on their personal driving and claim record. In moving to this non-discriminatory system, British Columbia was reflecting the

<sup>14</sup> ICBC Annual Report, 1977.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Vancouver Sun*, 13 September 1977.

<sup>17</sup> *Ibid.*, 23 April 1977.

<sup>18</sup> *Hansard*, 7 September 1977, 5318.

general trend (the Ontario government had directed the auto insurers to end their practice of basing rates on age, sex, and marital status).<sup>19</sup>

The private insurance companies opposed this perceived government interference in a fundamental aspect of the insurance business. The Insurance Bureau of Canada, the industry lobby association, insisted that several aspects of the new program would make it difficult to compete and charged that ICBC, which did not pay corporate taxes, subsidized optional rates with profits generated from compulsory insurance. It charged that the Social Credit government was using ICBC as a political investment to be managed for political return. The industry was particularly upset as it complained that the Socreds had won the 1975 election “with support from the insurance industry” after promising to allow private companies to compete with ICBC. Specifically, the industry argued that basing insurance rates only on the driving record was a “primitive system” certain to lead to unbalanced and unfair results. It also claimed that the ten private companies then operating in the province were leaving.<sup>20</sup> In a speech to the Victoria Rotary Club in March 1980, the president of the Insurance Bureau of Canada attacked Premier Bennett as he recalled that, before the 1975 election, the premier had said that insurance rates should be based on competition, not politics. Instead the new non-discriminatory scheme was based on “political and social pricing.”<sup>21</sup> The government defended the move to the new rate structure and the operation of ICBC in general. The NDP used the government’s support of public auto insurance to attack its apparent lack of principles. Opposition leader Dave Barrett sarcastically welcomed the change of heart:

I don’t have too much to say on ICBC, other than to say that those raving socialists over there have gone too far. They have expanded the program to a degree that is shocking even in the Soviet Union. They have embraced government-owned car insurance as if it were their own child, and as foster parents they have denied all maternal and paternal responsibility. As one who has suffered from vindictive slings and arrows of mad opposition who screamed doom and gloom about the government insurance business, let me say with some humility, welcome to the socialist club.<sup>22</sup>

Following its re-election in May 1983, the Bennett government launched a severe financial restraint program. After a review of all

<sup>19</sup> *Victoria Times*, 9 August 1979.

<sup>20</sup> *Vancouver Sun*, 30 January 1980.

<sup>21</sup> *Ibid.*, 28 March 1980.

<sup>22</sup> *Hansard*, 23 May 1980, 2567.

programs and Crown corporations designed to increase efficiency and to reduce expenditures, the government announced in May 1984 that it would sell ICBC's small general property insurance division. Opposition critic Dennis Cocke objected to the sale because ICBC provided province-wide coverage, made a small profit, and provided the government with an inside view of the general insurance business. When he questioned the mandate for the sale, a government minister shouted: "We won the election, in case you didn't notice." Cocke sharply replied: "No, the insurance companies won the election, we know that. You're their representative and always have been."<sup>23</sup>

In 1986, the government, now led by Bill Vander Zalm, was re-elected. ICBC was not an election issue and the government seemed content with the current role of the corporation. When the NDP suggested that the government was manipulating insurance rates to gain public favour, Lyle Hanson, the minister responsible, asserted that ICBC was effective and that other jurisdictions, including Ontario, were reviewing the BC model: "The bottom line is that ICBC is a user-pay, non-profit, break-even corporation. There haven't been grant payments to government out of ICBC. Government has nothing to do with it."<sup>24</sup>

Moreover, ICBC was funding a number of social programs, including traffic safety education programs in schools and communities. By 1980, it was assisting with the government's anti-alcohol and drug initiative through the CounterAttack impaired driving initiative, through which it funded police overtime in order to provide additional enforcement. It was also responsive to the needs of its independent insurance agents, and it kept the support of civil litigators by not pressing for limits on injury payouts. ICBC's financial position remained strong, and, by the end of 1990, it had \$168 million in reserves.

#### THE NEW DEMOCRATS RETURN

The New Democratic Party, under Mike Harcourt, won a decisive majority of the seats (but not the popular vote) in the October 1991 election, and a resurgent Liberal Party became the official opposition. ICBC management immediately presented Moe Sihota, the labour and

<sup>23</sup> *Ibid.*, 15 May 1984, 4773. When the sale was completed in early 1985 the corporation recorded a \$5.3 million loss due to the retained liabilities of past claims. The government did not allow ICBC to retain \$8.4 million of profit from prior years from the general insurance division to offset the loss, and it directed that these funds be transferred to the government's general reserve. This is the first time the government took profits from ICBC.

<sup>24</sup> *Hansard*, 22 April 1988, 4022.

consumer minister with responsibility for ICBC, with a forecast of a \$180 million loss, primarily due to increasing claims and claim costs as well as lower income due to lower interest rates.<sup>25</sup> ICBC management sought a 24 percent average rate increase for 1992, but the cabinet only granted 19 percent. The NDP accused the previous government of ignoring ICBC's forecast and setting artificially small rate increases for 1990 and 1991 in the hope of improving its election chances. Finance Minister Glen Clark denounced such political interference: "The ICBC rates were completely politically manipulated. For three years management was overruled by the politicians. The rates were kept low over the course of that time. We're trying to clean up the mess we inherited from the Social Credit."<sup>26</sup>

In May 1992, the NDP fired the president, replaced all the board members with their own appointees, and directed the corporation to reduce expenditures. A new "no crash, no cash" policy made it more difficult to prove whiplash injury (the majority of bodily injury claims). By 1993, the number and cost of claims had declined somewhat and, together with two years of significant premium increases, produced a surplus of \$156.1 million, which ICBC used to restore the rate stabilization reserve that had been expended to balance the losses of 1991 and 1992.<sup>27</sup> The rate stabilization reserve is the accumulated surplus from prior years, which can be used to moderate premium increases in a future year.

In the early 1990s, ICBC became more active in promoting and funding traffic safety initiatives in order to reduce claims and to support the government's social agenda. A significant change occurred in 1996, when the government transferred all driver licensing services from the Motor Vehicle Branch to ICBC. This transfer of over 460 employees and \$40 million would allow the greater integration of services, a closer linking of vehicle and driver data, and it would increase the collection of outstanding traffic fines by denying annual insurance, whereas the Motor Vehicles Branch generally had contact with drivers every five years when they renewed their licences. The government took pains to explain that it would continue to pay for the driver licence program by allowing ICBC to deduct its cost from the driver licence fee revenue it would now collect on behalf of the province.<sup>28</sup>

In addition to the vehicle registration and driver licensing program (both paid by the province), the corporation continued to use its own funds to expand traffic safety programs, including the new photo-radar

<sup>25</sup> ICBC Annual Report, 1992.

<sup>26</sup> *Hansard*, 19 May 1992, 1636.

<sup>27</sup> ICBC Annual Report, 1993.

<sup>28</sup> *Hansard*, 18 July 1996, 581.

initiative, the redesign of road intersections, and the CounterAttack program. Another increase in ICBC's expenditures occurred in 1994, when the government mandated that the corporation, rather than the Medical Services Plan (MSP), would be the prime insurer for medical claims. This change resulted in savings to the MSP of approximately \$13 million in the 1994-95 fiscal year as this cost was transferred to drivers through their insurance premiums.<sup>29</sup> ICBC president Thom Thompson confirmed these changes in mandate when the 1995 Annual Report stated that ICBC was becoming a loss prevention company rather than just an insurance company.<sup>30</sup>

Glen Clark became premier in February 1996, following the resignation of Mike Harcourt. The next month he announced a freeze on all taxes and fees, including automobile insurance rates, as a major plank (Freeze for Families) in the government's re-election platform. Despite trailing in the popular vote the government held on to a small majority of seats in the May election. However, the rate freeze, retroactive to 1 January 1996, contributed to a loss of some \$134.9 million at ICBC in that year, reducing total reserves to approximately \$210 million.<sup>31</sup> Nevertheless, the government continued to consolidate driver and vehicle-related programs with ICBC. In 1997, it transferred the commercial transport and compliance operations of the Motor Vehicle Branch to ICBC, using a funding arrangement similar to that of driver licensing whereby ICBC remitted the licence fees less their operating costs. The opposition argued that this arrangement put ICBC in a conflict of interest as both the regulator and a seller of insurance, and it predicted a loss of accountability as these programs would be delivered by ICBC and not directly by the government.<sup>32</sup>

The close link between the NDP government and the insurance corporation during the 1990s was reinforced in the summer of 1998 with the appointment of Robert Williams, an important cabinet minister in the 1972-75 Barrett government and a senior policy advisor to Premier Clark, as chair of the ICBC board of directors. The NDP-appointed board had few external directors with any financial background, but all supported the government's policy to improve traffic safety. Shortly after the Williams appointment, the government, without any public announcement, ordered ICBC to assume the full cost of administering the vehicle and driver licensing program in October 1998. This saved

<sup>29</sup> *Ibid.*, 30 March 1995, 13161.

<sup>30</sup> ICBC Annual Report, 1995.

<sup>31</sup> *Ibid.*, 1996.

<sup>32</sup> *Hansard*, 17 July 1997, 5438.

the government approximately \$50 million annually,<sup>33</sup> although it still collected the fees (this despite a Supreme Court of Canada decision suggesting that these fees amounted to a tax).<sup>34</sup> Effectively, drivers were now paying both the government (through the driver's licence fee) and ICBC (through the insurance premium) for the same service.

By the year 2000, ICBC customers were funding all or a major part of a variety of government-mandated programs, including driver testing and licensing, commercial vehicle enforcement, anti-speeding (photo radar), drinking and driving (CounterAttack), fine collection, intersection improvements, and driver education. The cost of these non-insurance programs totalled approximately \$135 million (excluding payments to appointed agents).<sup>35</sup> Nevertheless, lower average costs for bodily injury claims between 1998 and 2000 resulted in a relatively strong balance sheet despite the continuing rate freeze and a special \$100 "Safe Driver Dividend" rebate announced in 2000 by Premier Clark. After deducting the \$218.5 million cost of the dividend rebate, ICBC began 2001 with approximately \$520 million in reserves.<sup>36</sup>

#### THE LIBERAL NEW ERA

The Liberal Party under Gordon Campbell won a decisive victory in the election of May 2001. The party had campaigned on a New Era platform that promoted a less intrusive, more efficient government and more freedom for the private sector to generate economic growth. Government would become more transparent, accountable, and outcomes-orientated. The new government had campaigned on a promise of more competition in the automobile insurance market as it implied that optional insurance rates were being held down by a subsidy from the basic, or mandatory, sector of the operation. Within weeks of assuming office the new government terminated the president and board of directors of ICBC and brought in Nick Geer, an executive in the private sector, as acting president and board chair.

Despite the NDP's pre-election \$218.5 million rebate and rising claim costs, the corporation's finances were reasonably healthy – unlike the situation during previous government changes in 1975 and 1991. However, ICBC announced a 7.4 percent average increase in rates in November

<sup>33</sup> ICBC Annual Report, 1998.

<sup>34</sup> The definition of a fee for service is found in Auditor General of Ontario, *Government User Fees* (Annual Report of the Office of the Auditor General of Ontario, Chapter 3, 2009), 146.

<sup>35</sup> ICBC Annual Report, 2000.

<sup>36</sup> *Ibid.*

and raised premiums again for 2002 and 2003. Optional rates rose by over 18 percent in these two years while basic rates rose by 8 percent. The government justified the rapid increase in optional rates by claiming that it was underpriced; however, the financial statements in the annual reports for these years do not support this. By the end of 2003, the total accumulated surplus had grown to \$535 million, with some \$510 million attributed to the optional line of business.<sup>37</sup>

The Liberal government was much more ideologically driven than its Social Credit predecessor. As promised during the election, the government immediately cancelled the unpopular ICBC-funded photo-radar program, and it imposed a severe financial restraint program in keeping with the government-wide spending-reduction program. On the day he assumed office, Premier Campbell announced a 25 percent reduction in the personal income tax, which acted as a spur to an expenditure reduction initiative and a detailed review of all government programs and Crown corporations. This core review, led by Treasury Board staff, was designed to question the continued relevance of major programs as well as their efficiency and effectiveness. The review culminated in a decision by the cabinet on each program's future and structure. The results of the ICBC review were ready in November 2003. The government decided to keep ICBC as a public corporation and thereby avoided a likely political storm. ICBC had earned the support of the insurance agents, the trial lawyers, health providers, and other influential groups, and the government did not want to alienate them. It announced that ICBC would continue to provide mandatory basic insurance as well as road safety and education programs. Nevertheless, the government announced some changes. It would encourage greater competition in optional insurance in order to increase choice and to reduce premiums, transfer decisions respecting basic insurance structure and rates to the British Columbia Utilities Commission (BCUC),<sup>38</sup> and reclaim most of the commercial transport inspection and compliance program due to a potential conflict in roles for ICBC. What was not announced was that, for the next three years, ICBC would continue to pay approximately \$27 million per year for the commercial vehicle program.<sup>39</sup>

The most important change involved the proposed depoliticization of the oversight and the rate-setting of basic insurance by transferring this authority from the cabinet to the BCUC. In defending the new scheme

<sup>37</sup> ICBC Annual Report, 2003.

<sup>38</sup> *Hansard*, 20 November 2003, 8063.

<sup>39</sup> ICBC Annual Report 2003.

for basic insurance, Finance Minister Gary Collins denounced the NDP's rate freeze and the rebate to BC drivers: "The manipulation of their rate got so obscene that just prior to the last election, the NDP government not only dealt with the rates, but they actually sent people cheques."<sup>40</sup> Apparently the notion of returning excess funds to premium payers was foreign to the new government's thinking.

In explaining the new responsibilities of the BCUC and of ICBC in general (the 2003 legislation gave the commission authority over optional insurance as well, but this was never proclaimed), the finance minister outlined the major objectives of the new regulatory scheme. The BCUC would ensure that the basic insurance business would be efficient and of high quality, with rates being set in an open and transparent manner. With regard to optional insurance, Collins said that consumers would benefit through innovation and price competition from the private sector. Like the new arm's-length relationship with the BC Ferries Corporation, the structure would take politics out of the automobile insurance business: "It will probably take politicians a while to get used to not telling ICBC what to do all the time," he said.<sup>41</sup>

The oversight of ICBC was something new for the utilities commission, which had mainly been concerned with regulating monopoly public and private utilities, including natural gas and electricity utilities. Commission members were appointed for a fixed term and operated in a formal semi-judicial manner on the basis of written submissions and oral presentations from the regulated body as well as from approved interveners. The BCUC provides written reasons for its decisions and is funded by the regulated bodies. The new BCUC process for setting rate structure and premiums posed a major challenge to the members of ICBC management, who were used to an annual trip to Victoria for closed-door meetings with members of cabinet and senior public servants in order to seek rate approvals. The government had generally relied on the facts and forecasts prepared by ICBC's insurance experts and actuaries.

Insurance companies are different from most other companies in that they receive the bulk of their income up front in the form of premiums and incur their expenditures later. Their profitability is derived from the return on the invested income less administration costs. The key variables are the number and cost of claims, changes in administration costs, and the rate of return of the investment portfolio. Forecasting future cost exposure on current policies is easier for automobile insurance

<sup>40</sup> *Hansard*, 20 November 2003, 1145.

<sup>41</sup> *Ibid.*, 27 May 2003, 7104.

companies than for life insurance companies because the automobile policy is renewed each year, and the great majority of claims are paid within eighteen months of the filing (property claims generally have a shorter settlement period).

The government had saddled the BCUC with a hybrid organization in that ICBC was created as a public Crown corporation to provide BC drivers with low and, as much as possible, relatively stable insurance for liability claims and an optional line of business meant to compete with private insurers. In addition, ICBC managed a government service operation that issued vehicle registrations and drivers' licences and that funded road safety enforcement and education programs. The commission was required to oversee and set premium rates for only the basic insurance business. Since basic insurance represented some 60 percent of ICBC's revenue and expenditures, any decision on basic rates had significant ramifications for the viability of the whole corporation.

The government's new management model was designed to ensure that ICBC would not take advantage of its market power (it sold about 87 percent of optional policies in 2003) and its pricing power (it did not pay federal or provincial taxes on its profits) to drive down optional premiums. The key was the concept of the minimum capital test (MCT), which the federal Office of the Superintendent of Financial Institutions (OSFI) employed as a guide to judge the financial stability of federally regulated insurance companies, banks, and pension plans. It was a tool designed to promote policies and standards to control and manage risk and to ensure that its regulated companies had sufficient capital on hand.

Previously, ICBC had not been subject to a formal capital requirement, but the government decided formal capital targets should be established to manage its risk (ICBC's financial results are part of the government reporting entity) and to create a more equal relationship with private insurers with regard to setting optional rates. A joint government-ICBC committee recommended in March 2004 that the ICBC's retained earnings be allocated to the optional insurance business in order to meet a recommended 170 percent MCT. This would require that basic premiums rise to meet the overall ICBC target of 110 percent.<sup>42</sup>

In July 2003, a cabinet order required the BCUC to exercise its powers respecting ICBC in certain ways and formalized cabinet's authority to set targets for ICBC's capital and, indirectly, its profits. Through this order, known as Special Direction IC<sub>2</sub> (SD IC<sub>2</sub>), the government used its au-

<sup>42</sup> David Morhart to Honourable Gary Collins and Honourable Rich Coleman, 17 March 2004. Copy of letter obtained through an FOI request to ICBC.

thority to determine the rules of the game respecting BCUC's regulation of ICBC. It also directed ICBC to achieve MCT targets of 100 percent for basic, 200 percent for optional, and 110 percent for the total corporation by 2014.<sup>43</sup>

It is interesting to note that the corporation's 5 July 2004 submission to the BCUC for approval of a general cost allocation methodology, which incorporated the MCT targets, was dated a day before the government order was made public. Two months earlier, Nick Geer, the president of ICBC, had been terminated, prompting speculation that he opposed the government's plan for the future direction of the corporation.<sup>44</sup>

The adoption of an MCT target may have been a prudent measure to guide both the management of ICBC and its regulator; however, the application of an overly conservative risk-management standard led to important financial consequences in the coming years.<sup>45</sup> Using the MCT target, ICBC determined it was facing a significant shortfall in capital reserves for basic insurance, while the premium increases announced from 2001 to 2003 (and more sales) resulted in a healthy capital reserve for the optional business. The imbalance was such that even the Insurance Bureau of Canada was concerned and suggested that the optional reserve should subsidize basic insurance.<sup>46</sup> ICBC management opposed this approach to solving the imbalance, but in October 2005 the government ordered ICBC to transfer \$530 million in capital reserves to basic. Since this action would impinge on BCUC's jurisdiction in regulating ICBC's basic insurance, cabinet amended SD IC<sub>2</sub> to require the commission to accept actions taken by ICBC in compliance with any government direction issued to the corporation.<sup>47</sup>

The rationale for setting the optional reserve target at 200 percent was not provided, but ICBC's 2005 year-end report noted that the MCT capital targets for optional and total operations had been achieved – some nine years ahead of the date required by SD IC<sub>2</sub>. Clearly, the optional insurance business continued to be very profitable for ICBC and, by inference, for the private insurers. If a free market was operating in the optional insurance field one might expect private insurers to lower their prices in order to attain greater market share. While some price competition

<sup>43</sup> British Columbia Utilities Commission Decision (hereafter BCUC Decision), 19 January 2005, 11-14 <http://www.bcuc.com>. The commission was considering a legal challenge to SD IC<sub>2</sub> when the government amended its legislation to exclude this action.

<sup>44</sup> *Times Colonist*, 10 July 2004. Paul Taylor, recruited by the Liberal government as deputy finance minister, became president in September.

<sup>45</sup> For example, in determining the MCT the corporation used only half of the actual reserves on hand. See BCUC Decision, 19 January 2005, 79.

<sup>46</sup> BCUC Decision, 13 July 2006.

<sup>47</sup> *Ibid.* A further \$100 million was transferred in the following year.

was occurring for the lowest-risk drivers, ICBC also lowered its rates for these premium clients through rate structure adjustments and safe driver discounts.

In order to recognize rising bodily injury costs and in order to build the basic insurance capital reserve, the BCUC approved a 6.5 percent rate increase for 2006 and a further 3.3 percent for 2007. At the same time, ICBC reduced optional rates for low-risk drivers in 2006 and an average of 3.8 percent for all optional policies in 2007. ICBC management now adopted an overall MCT target of 150 percent (rather than the mandated 110 percent) and stressed that the financial health of the corporation and enhanced customer relations were priorities. The objective of low rates was no longer being discussed in its public documents. In the 2006 annual report, return on equity (profitability) was dropped as a performance measure and replaced by the MCT.<sup>48</sup>

The desire for greater profits had also infused ICBC's regulator. In its 2006 rate decision the BCUC suggested that the MCT target for basic should be considered as a minimum. In response, ICBC submitted a rate increase request for 2007 using a capital target of 130 percent for basic. The commission was receptive to using the logic of some catastrophic financial event every six to seven years and even suggested that the need for profitability trumped low rates (or even predictable rates): "On balance considering IC2, the Commission considers that the financial strength and stability of the basic insurance business should be given relatively more weight than maintaining stable and predictable rates."<sup>49</sup>

By January 2008, ICBC was a highly profitable organization with \$9.6 billion invested. Net income for the previous year was approximately \$500 million, and the total capital reserve had reached a new record of \$2.4 billion.<sup>50</sup> The corporate MCT had risen to 188 percent, but ICBC management continued to target 150 percent for 2008. Comparing the capital reserves to premiums written (policies sold), there was enough basic capital to operate for seven months. The equivalent number for optional insurance was almost eleven months.

Towards the end of the decade various cabinet orders had greatly circumscribed the regulatory control of the utilities commission over the basic insurance business and over ICBC in general. For example, ICBC had been developing a modified basic rating system that would increase the proportion of basic premium income paid by higher-risk drivers based

<sup>48</sup> ICBC Annual Report, 2006.

<sup>49</sup> BCUC Decision, 9 January 2008.

<sup>50</sup> ICBC Annual Report, 2007.

on traffic violations and accidents. In January 2007, a cabinet directive to ICBC provided guidelines for this new structure, which further limited the BCUC's discretion when it received the corporation's rate design application. During the review, ICBC advised the commission that the complicated nature of the proposed rate design made it "undesirable, and potentially counterproductive" to alter its plan.<sup>51</sup> The BCUC approved the application.

The government also intervened in early 2010 by directing ICBC to set aside \$400 million from optional capital as a "transformation" reserve to upgrade its corporate computer and business systems.<sup>52</sup> Had this fund been pro-rated in the normal fashion, the basic operation reserve would have been assigned at least \$250 million of the total.

#### AN EMBARRASSMENT OF RICHES

The world financial crisis of 2008 reduced ICBC's investment return, but the rebound of the financial markets the next year assisted the corporation in recording a net operating profit of over \$560 million in 2009. Despite a cumulative reduction in optional rates of about 7 percent during the last two years (and no increase in basic rate) the accumulated total capital reserve reached \$3.6 billion, with the overall MCT now at 240 percent.<sup>53</sup> Using the equity-to-premiums-written analysis, ICBC now had enough reserve capital to provide free auto insurance for a year. The accumulated reserve capital was so large that even BCUC questioned the growing surplus. In its review of ICBC's May 2009 request for a more streamlined basic rate review process, the commission ordered the corporation to develop a surplus reduction plan for its review by June 2010.<sup>54</sup>

Within six weeks of the commission's order the provincial government directed ICBC to adopt a set of rules respecting the release of basic capital reserve funds. In essence, the rules would require the actual basic reserves to be 20 percent greater than the MCT target before any funds could be released.<sup>55</sup> On 31 May 2010, four days after the cabinet order, ICBC submitted a capital expenditure plan to the BCUC incorporating the release rules detailed in the cabinet order.<sup>56</sup>

<sup>51</sup> BCUC Decision, 9 January 2008.

<sup>52</sup> ICBC Annual Report, 2009.

<sup>53</sup> *Ibid.*

<sup>54</sup> BCUC Decision, 6 April 2010.

<sup>55</sup> Michael de Jong to Nancy McKinstry, Government of British Columbia, Order-in-Counsel No. 287, 27 May 2010.

<sup>56</sup> BCUC Decision, 31 August 2010.

ICBC managers seemed anxious to retain as much reserve capital as possible, although it was not clear if staff within the provincial finance ministry was directing them. In May 2009, the provincial revenue forecast began to rapidly decline as a result of the world economic crises. The newly re-elected Liberal government announced the adoption of the national harmonized sales tax (HST) and a series of other revenue enhancement measures in an attempt to plug the hole in the provincial budget. The switch from the provincial sales tax to the HST came with a \$1.6 billion inducement from the federal government, but it was to lead to a major political controversy since, during the 2009 election, the provincial government had denied the potential for a sales tax change. The ICBC accumulated capital, which until now had helped moderate the increase in the provincial debt, now took on a new lustre as another revenue source.

The rapid decline in resource revenues led to a major increase in the provincial government deficit forecast. The Liberal government had campaigned as good financial managers and had even passed legislation to ban budget deficits. The size of the 2009-10 shortfall must have come as a shock, and the government was determined to reduce expenditures and raise fees (but not corporate or personal income taxes) to close the budget gap in the 2010-11 fiscal year.

The most fundamental change in the relationship between government, ICBC, and its customers occurred with the 2010 provincial budget. On 4 March 2010, Finance Minister Colin Hansen confirmed that, as the sole shareholder, the province, over three years, would take \$778 million of ICBC's "excess" capital from the optional capital reserve as a dividend in order to reduce provincial borrowing costs. During the thirty-six years of its operation, most citizens had regarded the corporation as a not-for-profit supplier of low-cost automobile insurance similar to its predecessors in Saskatchewan and Manitoba. In fact, ICBC's legislation did not permit a transfer of its funds to the government. Henceforth, any reserve capital greater than the optional MCT target would be considered as a dividend for the benefit of the taxpayer rather than as a way of reducing premiums. The government now referred to ICBC as a "commercial Crown" similar to BC Hydro, the Liquor Distribution Board, and the BC Lotteries Corporation, and it tightened its control over the corporation by requiring Treasury Board approval for all projects "that support[ed] government initiatives."<sup>57</sup>

<sup>57</sup> Shareholder's Letter of Expectations for 2011, 17 November 2010. <http://www.icbc.com>. Until this change the government considered ICBC as a non-profit Crown corporation, much like

Even during the severe economic restraint program of the Bill Bennett era the government did not consider turning ICBC into a profit centre in order to enhance government revenue.<sup>58</sup>

Vaughn Palmer, the experienced political columnist for the *Vancouver Sun*, denounced the transfer as a hidden tax. He noted that the surplus had been building for a number of years and that for two years ICBC had been suggesting options for using the capital, including a good-driver rebate similar to that provided during the last years of the NDP government. In contrast, according to Palmer: "The BC Liberals had different notions, their own surpluses were long gone, vaporized by the combination of an economic downturn and their own unwillingness to level with the electorate before it was too late. They were desperately short of cash and those ICBC reserves were just sitting there, like a string of plump little sparrows."<sup>59</sup> A few days later, in an editorial entitled "Stealth Tax," the *Vancouver Sun* was highly critical of the fact that the change was made public through an obscure passage in the budget papers. More "odious" still was the fact that the action was a tax on the virtuous as the reserve funds resulted from over-charging good drivers: "It is debatable whether in the first place the government should have been forcing ICBC to overcharge good drivers so that the private insurers could compete for their business."<sup>60</sup>

The appropriation of the optional surplus never developed into an issue of serious political concern as public discourse was occupied by the imposition of the HST. During the debate on the details of the enabling legislative changes, Bruce Ralston, the NDP finance critic, got to the heart of the matter by questioning the usage of the MCT and its adoption as the standard for determining the size of the capital reserve. Finance Minister Hanson initially asserted that the MCT was required by international standards: "It's not the government's role to determine what the cash reserves should be. It's not the ICBC board's role to determine what the cash reserves should be. These are actually dictated by international standards within the insurance industry."<sup>61</sup> The finance minister admitted that there were no international standards, but he maintained that ICBC should follow the OSFI guidelines to ensure a "level playing field" with private insurers. Hanson left the impression that the now 200 percent target MCT for optional insurance was the same as that in the

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the insurance fund managed by WorkSafeBC.

<sup>58</sup> Bob Plecas, *Bill Bennett: A Mandarin's View* (Vancouver: Douglas and McIntyre, 2006).

<sup>59</sup> *Vancouver Sun*, 5 March 2010.

<sup>60</sup> *Ibid.*, 10 March 2010.

<sup>61</sup> *Hansard*, 4 March 2010, 3172.

OSFI guidelines, which was only a suggestion and was set at 150 percent. When asked how the government's establishment of the MCT standard aligned with the BCUC mandate over basic insurance rates, the finance minister implied that the standard-setting power was only in place to determine the amount of surplus optional capital.<sup>62</sup> He failed to mention that the government had been setting the MCT for basic insurance for the last six years. Ralston did not include comparisons with the public automobile insurance in Saskatchewan or Manitoba. The Saskatchewan Auto Fund works with an MCT range of 75 to 150 percent and ended 2010 with total reserves equalling 130 percent. The Saskatchewan MCT target reserve equates to approximately 30 percent of premiums written.<sup>63</sup> The Manitoba Public Insurance operates basic insurance and an extension insurance similar to the optional in British Columbia. The Manitoba Public Utilities Board set the basic capital reserve at between 10 and 20 percent of premiums written. The Manitoba reserve for optional was set at approximately 30 percent of premiums written.<sup>64</sup> If the BC government had followed the Saskatchewan/Manitoba example and set the basic target at 20 percent of premiums written, and the optional target at 30 percent, it would have greatly reduced the amount of reserves required by ICBC.

In the ten-year period prior to 2004, before the original 100/200/110 percent MCT formula was mandated, ICBC's reserves averaged about 11 percent of premiums written.<sup>65</sup> In 2005, ICBC's reserves to premiums written was 36.8 percent, with basic at 25.7 percent and optional at 50.9 percent. Four years later, the total reserves had grown to almost 100 percent of premiums written, with basic at 77.1 percent and optional at 126.6 percent. If the Saskatchewan/Manitoba ratios had been in place ICBC would have required some \$900 million in total capital reserves in 2009, instead of the \$3.6 billion it actually held. Of the \$2.7 billion over-capitalization, \$1.2 billion was in basic and \$1.5 billion was attributable to optional (after the government-mandated \$630 million transfers in 2005 and 2006).

Why the government chose such a conservative approach to setting the reserve targets for ICBC requires further analysis. Why the BCUC accepted these targets and even pressed for an increase in the basic reserve is another question as it had its own accountants to advise it.

<sup>62</sup> Ibid., 23 March 2010, 3574.

<sup>63</sup> Saskatchewan Auto Fund Annual Report, 2011. [http://www.sgi.sk.ca/pdf/annualreports/SGI\\_2011](http://www.sgi.sk.ca/pdf/annualreports/SGI_2011).

<sup>64</sup> Manitoba Public Insurance Annual Report, 2011. <http://www.mpi.mb.ca/en/PDFs/2011>.

<sup>65</sup> ICBC Annual Reports, 1994-2003.

Perhaps with their legal training they followed the lawful edicts of the government and did not seek a broader perspective. Standard and Poor's and the DBRS rating agencies both expressed capital adequacy for auto insurers in terms of premiums written and used much lower standards in recognition of the fact that most automobile claims are paid in eighteen months.<sup>66</sup> A large reserve to account for a sharp reduction in the number of basic policies sold was unnecessary as the basic liability insurance is mandatory. Despite the re-entry of private insurers into the BC market in the early 1980s, ICBC still averaged nearly 85 percent of the optional market, which accounted for a major part of its profits in the later years. ICBC utilized the re-insurance market for risk mitigation for potential major losses. All these reasons suggest that the MCT ratios (as defined by ICBC) were not appropriate.

Why were premium rates higher than required? Several explanations are possible. The government did not have staff tasked with overseeing ICBC's operations but relied on ICBC to provide rate and financial costing scenarios.<sup>67</sup> Ministerial responsibilities for ICBC often moved from minister to minister (e.g., at least eight ministers were responsible for ICBC between 1991 and 2001), and the pattern continued with the Liberal administration. Government finance staff encouraged larger reserves as, when incorporated into the province's financial statements, they lowered total government debt. Most stakeholder groups were satisfied with the status quo; the trial lawyers supported the full tort claims system, and by 2010 approximately \$327 million was being paid to insurance brokers as commissions. Over time, ICBC's annual reports contained less comparative data and more derived ratios. Client satisfaction and employee engagement became key performance measures, and low premium costs slowly faded as a measure of success.

After the 2003 changes lobbyists for the private insurance industry occasionally sought public support for more "choice" but seemed satisfied with the status quo, especially since the government's MCT targets were keeping rates high. With the healthy balance sheet, a generally responsive customer-focused staff, and relatively stable premiums, the corporation did not draw much media attention or public concern.

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<sup>66</sup> Standard and Poor's, *Global Credit Portal*, June 2012; DBRS, *Rating Canadian Property and Casualty Insurance Companies*, March 2011.

<sup>67</sup> *Hansard*, 23 March 2010, 3574.

## CONCLUSION

During the forty years under review ICBC evolved from a concept to one of the largest insurance corporations in Canada with almost \$12 billion in investments. ICBC was created by a government that believed in an activist role for the state so as to promote a better standard of living for the citizens of British Columbia. It was fundamentally transformed some forty years later by a government committed to a limited role for the state, one designed to assist the private sector to prosper and indirectly provide the citizens with a better standard of life.

ICBC has always been closely linked to the provincial government. It has been influenced by, and sometimes had a direct influence upon, the fortunes of the party in power. On a number of occasions the governing party directed the insurance rates and rate structure in an attempt to gain political advantage. There have been sporadic efforts to depoliticize the operation of ICBC, but since voters are its customers it is necessary for all governments to retain influence over its affairs. The alignment of interest between the government and ICBC grew with the transfer of the driver licensing function, the greater emphasis on traffic enforcement and auto theft, provincial violation ticket debt collection through vehicle licensing, driver training, public education, and the provision of data on vehicles, drivers, and accidents.

Public insurance was designed to be run on a break-even basis. This changed after the 2001 election when the Liberal government encouraged the accumulation of an extraordinary level of surplus capital. The nature of the public auto insurance was changed even more with the 2010 appropriation of most of ICBC's optional reserves, and the public auto insurer now became another profit centre for the government. It seems ironic that, by 2010, the Liberal government, which promised to de-politicize the relationship with ICBC, had more control than ever over its operations and rates through various cabinet directives.

This process has continued to the time of writing as ICBC was ordered to shift some of its optional reserve to the basic insurance business as part of the government's 2013-14 budget plan.<sup>68</sup> Hugh Curtis's 1974 warning that ICBC would need government support was wrong as it is the government that now requires ICBC's financial assistance.

<sup>68</sup> *Times Colonist*, 21 February 2013. The transfer of the funds allowed ICBC to maintain the 2012 insurance rates for 2013. While holding the rates constant would normally be considered positive news, no public announcement was made. In fact, when the author requested a copy of the transfer request to the government ICBC replied that the request had been verbal. It remains to be seen whether the re-elected Liberal government will revert to taking any excess optional profit in future.

The NDP government of Dave Barrett is remembered for many innovative policies and programs, and the creation of ICBC has been one of its most enduring success stories. Whether the new profit-driven ICBC will remain a success remains to be seen.