IN THE MATTER OF

the Insurance Corporation Amendment Act,
2003, S.B.C. 2003, C. 35
and the Insurance Corporation Act R.S.B.C. 1996, C.228
and the Utilities Commission Act
R.S.B.C. 1996, Chapter 473

IN THE MATTER OF

INSURANCE CORPORATION OF BRITISH COLUMBIA

2004 REVENUE REQUIREMENTS APPLICATION

DECISION

November 12, 2003

Before:

Len Kelsey, Commissioner and Panel Chair
Murray Birch, Commissioner
Peter Vivian, Commissioner

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1 INTRODUCTION

1.1 History of the Insurance Corporation of British Columbia

In 1973, under the authority of the *Insurance Corporation Act*, the provincial government established the Insurance Corporation of British Columbia ("ICBC", "Corporation," "Applicant") as a provincial Crown Corporation to provide universal auto insurance to all British Columbia motorists. ICBC was the sole provider of auto insurance in British Columbia when it was set up. The enabling legislation was amended soon after inception of ICBC to allow private insurance companies to compete for the Optional Insurance business. ICBC remained as the sole provider of the Basic Insurance coverage.

Following the 1996 merger with the former Motor Vehicle Branch, ICBC assumed the responsibility and costs for driver licensing and registration services, road safety programs, and commercial vehicle compliance. The commercial vehicle compliance function was transferred to the provincial government in March 2003 with ICBC paying an annual fee for three years to fund the service.

ICBC ranks among the largest corporations in British Columbia and is one of the largest property and casualty insurers in the country. It currently employs a work force of approximately 4,800 (measured on a full time equivalent basis). ICBC's business partners are wide ranging and include insurance brokers, law enforcement agencies, members of the auto repair industry, defence lawyers and health service providers.

1.2 Universal Compulsory Automobile Insurance ("Basic Insurance") and Optional Insurance ("Optional Insurance")

ICBC operates two principal lines of business, the Basic and Optional Insurance programs. The Basic Insurance program is compulsory for all motorists in the province whereas the Optional Insurance program is not compulsory and ICBC competes in the open market against products offered by private insurance companies. The following listing from ICBC's Annual Report highlights the coverages offered under the respective programs.

1.2.1 Basic Insurance

Third-Party Legal Liability
Provides protection against claims by other parties for bodily injury, death or property damage to a limit of $200,000.

Accident Benefits
These benefits cover the insured person, household members or occupants of the insured's vehicle for medical and rehabilitation costs (up to $150,000 per person) regardless of who is at fault in a motor vehicle accident.

Underinsured Motorist Protection
Protection is provided up to $1,000,000 for coverage to protect the insured person and household members from the cost of injuries caused by another driver who does not carry sufficient insurance to pay for claims.

Protection against Hit-and-run and Uninsured Motorists
Protection is afforded to the insured person if they are injured or killed by an uninsured or unidentified motorist in a jurisdiction that does not have a special fund to pay for bodily injury claims caused by such motorists.

1.2.2 Optional Insurance

Third-Party Legal Liability
Motorists may increase Third-Party Legal Liability above the level provided by Basic Insurance.

Collision
Collision coverage provides for the repair or replacement of the insured person's vehicle if it is damaged due to a collision with another vehicle, a person or an object.

Comprehensive
Comprehensive coverage protects the insured person against loss or damage caused by fire, lightening, theft, vandalism, and earthquake.

Roadside Plus
This package combines eight coverages that include Loss of Use, Travel Protection, Rental Vehicle coverage, Family World Wide Transportation, Lock Re-Keying, Theft Deductible Waiver, Destination Assistance, and Emergency Roadside Expense Repayment.

1.3 Recent legislation and the role of the British Columbia Utilities Commission

The *Insurance Corporation Amendment Act, 2003, S.B.C 2003, c. 35* ("Act") passed Third Reading on May 29, 2003 and was brought into force by Order in Council No. 0805 on August 12, 2003. The regulation of ICBC is set out in Part 2, Divisions 2 and 3 of the Act. Division 2 focuses on the role of the British Columbia Utilities Commission ("BCUC", "Commission") in the regulatory process and Division 3 deals with competition regulation.

The Act sets out, in general, the regulatory environment for ICBC and specifies (in Section 44) how the *Utilities Commission Act* is to be applied. ICBC is exempted from certain sections of the *Utilities Commission Act* and for other sections, references and definitions are amended to suit the particular business operations of ICBC.

ICBC is not to be considered as a "public utility" under the *Utilities Commission Act* nor can the Commission set rates for Optional Insurance.

1.3.1 Division 2 – Role of the British Columbia Utilities Commission

The Act specifies that the *Utilities Commission Act* applies. Section 44(1) states:

> Subject to subsections (3), (6) and (7), the *Utilities Commission Act*, other than sections 22, 23 (1) (a) to (d) and (2), 25 to 38, 40, 41, 45 to 57, 59 (2) and (3), 60 (1) (b) (ii) and (2) to (4), 97, 98, 106 (1) (k), 107 to 109 and 114 and Parts 4 and 5 of that Act, applies to and in respect of the corporation as if it were a public utility, and a reference in this Part to the *Utilities Commission Act* or to a provision of that Act is deemed to be a reference to that Act or provision as it applies for the purposes of this Act.

Section 44 (2) further states:

> Despite subsection (1), the corporation is not a public utility.

Section 45 specifically addresses the regulation of Basic Insurance and excerpts are as follows:

> 45 (1) If the corporation is authorized by the Lieutenant Governor in Council to provide universal compulsory automobile insurance, the corporation must make available universal compulsory automobile insurance in a manner, and in accordance with practices and procedures,

that the commission considers are in all respects adequate, efficient, just and reasonable.

45 (2) If the commission, after a hearing held on its own motion or on complaint, finds that the manner in which universal compulsory automobile insurance is provided by the corporation does not comply with subsection (1) or that the practices and procedures in accordance with which that insurance is provided do not comply with subsection (1), the commission must

(a) determine the manner or the practices and procedures, as the case may be, that comply with subsection (1), and
(b) order the corporation to comply with that manner or with those practices and procedures.

45 (5) The commission may exercise its powers and duties under this section in relation to the provision by the corporation of universal compulsory automobile insurance to the corporation's customer base as a whole or to classes of its customers, but not in relation to the provision by the corporation of universal compulsory automobile insurance to any one customer.

45 (6) Despite this section and section 44, and despite section 110 of the *Utilities Commission Act*, the commission does not have the power to change a term or condition of any plan of universal compulsory automobile insurance established under the *Insurance (Motor Vehicle) Act*.

It is important to note that in regulating the Corporation, the Commission is subject to direction by the Lieutenant Governor in Council. Excerpts from Section 47 are as follows:

47 (1) In addition to any other power the Lieutenant Governor in Council may have to issue directions to the commission, the Lieutenant Governor in Council may, by regulation, issue directions to the commission respecting the factors, criteria and guidelines that the commission must or must not use in regulating and fixing rates for the corporation, including, without limitation, one or more of the following directions:

(a) establishing financial outcome targets for the corporation generally and for its optional insurance business in particular, including targets for the corporation's capital base, within the meaning of the *Financial Institutions Act*, and the corporation's profits, and directing the commission to accommodate those targets when regulating and fixing those rates;

(b) identifying circumstances in which the commission is and is not to regulate and fix rates applicable to optional automobile insurance;

(c) establishing criteria on which rates may, and must not, be based;

(d) identifying activities the corporation may or must undertake on behalf of the government or under an enactment, and directing how those activities, and the costs related to them, are to be treated for the purposes of regulating and fixing rates;

(e) directing the commission to consider specified factors or criteria when regulating and fixing rates;

(f) authorizing the commission to determine any factor or criterion the commission considers to be relevant in relation to the regulation and fixing of rates.

47 (3) The commission must comply with any direction issued under subsection (1) or (2) despite

(a) any other provisions of the *Insurance Corporation Act* or the *Utilities Commission Act*, or

(b) any previous decision of the commission.

On August 12, 2003, Special Direction IC1 ("Special Direction"), approved by Order in Council No. 0806, was issued to the Commission. The complete Special Direction is included in Appendix A. Among the specific directives contained in the Special Direction, the following are particularly noteworthy:

> …the net income target for the corporation generally for 2004 is $36 million…;
>
> …the commission must fix rates for universal compulsory automobile insurance…;
>
> …ensure, that universal compulsory automobile insurance rates are not based on age, gender or marital status…;
>
> …the commission must not fix rates applicable to optional automobile insurance…;

1.3.2 Division 3 – Competition Regulation

The Commission is given a broad mandate to monitor and if need be, regulate, the business practices of ICBC in the Optional Insurance market**.**

Section 49 (1) of the Act addresses the issue of separation of businesses. Specifically, the section states:

> The commission must ensure that the universal compulsory automobile insurance business and the revenue of the corporation, other than revenue from the corporation's optional automobile insurance business, are not used to subsidize the corporation's optional automobile insurance business.

An excerpt from Section 49 (2) further states:

> For the purpose of subsection (1), the commission may issue any orders it considers necessary to ensure that the corporation's optional automobile insurance business and activities are segregated from the corporation's other businesses and activities for accounting purposes, and

> that, in addition, any other businesses and activities of the corporation that the commission considers appropriate are segregated from the remaining businesses and activities of the corporation for accounting purposes…

Section 50 (1) deals specifically with regulation of competition and states:

> If the commission finds after a hearing that the corporation has engaged in, is engaging in or is likely to engage in activities that have or are likely to have an effect of appreciably impeding or reducing any aspect of competition in relation to optional automobile insurance anywhere in British Columbia, or that are contrary to any regulation made under section 51 (1) (a), the commission may make an order:
>
> (a) prohibiting the corporation from continuing those activities, and
> (b) requiring the corporation to take the actions the commission considers appropriate to remedy the impediment to or reduction of competition.
>
> 50(4) Subject to section 45(6), an order under subsection (1) of this section or an interim order under subsection (2) may include terms relating to products, services, or activities of the corporation that are not related to optional automobile insurance.
>
> 50(5) The commission may invite the Commissioner of Competition appointed under the *Competition Act (Canada)* to attend any hearing referred to in subsection (1) and to make representations and submit evidence relating to competition issues.
>
> 52(1) At any time that it considers it appropriate to do so, the commission may hold a hearing to determine whether conditions in the optional automobile insurance market are such that it is necessary for the commission to exercise any or all of its powers under this Division.
>
> 43(2) In this Part, an activity has or is likely to have the effect of appreciably impeding or reducing competition if
>
> (a) the activity has or is likely to have a detrimental effect on existing or potential competition, and
> (b) the detrimental effect is or is likely to be large enough to be material, even though the detrimental effect may not be large enough to constitute preventing or lessening competition substantially within the meaning of sections 79(1) and 92(1) of the *Competition Act (Canada).*

Within the broad and general powers granted to the Commission, there is substantial scope for examining the operations of the Corporation in the competitive marketplace for Optional Insurance in British Columbia. In this regard, the Commission Panel takes issue with a statement in the Corporation's Final Reply Submission, page 4 which states (in part): "…there is nothing in the legislation that suggests that the Commission should adversely affect ICBC's optional insurance business." However, there are many issues that will have to be addressed in terms of separation of the two business lines whose solution may have, as an incidental effect, an "adverse" effect on the Corporation's Optional Insurance business line, at least as seen from ICBC's perspective.

There are references to the federal *Competition Act,* which is the legislation of general applicability for all businesses in Canada. The Commission Panel notes that pursuant to the definition in section 43(2) of the Act, the Commission may make a finding of an anticompetitive act on the part of ICBC, notwithstanding that such act may not meet the federal test spelled out for abuse of dominant position [Section 79(1)] or a merger that will prevent or lessen competition [Section 92(1)] in the *Competition Act*.

The clear intent of the Act is to mesh the federal and provincial jurisdictions in respect of the maintenance of competition in the Optional Insurance business marketplace. For the Corporation, this has both advantages and disadvantages. On the one hand, ICBC will gain the benefit of the so-called "regulated industry" defence that offers certain advantages to a company accused of anticompetitive behaviour under the federal legislation. On the other hand, the test for anticompetitive behaviour that the Commission is to apply under its provincial mandate may impose a higher level of responsibility on ICBC than exists under the federal legislation.

The Commission Panel agrees with ICBC that the Corporation's position in the automobile insurance markets in British Columbia can only be understood with reference to the history of ICBC and the decisions of various governments that have legislated the role to be played by the company. The Commission Panel agrees with the statement in ICBC's Final Reply, page 15 that "ICBC is the dominant writer of optional insurance due to the original structure, which established ICBC as the sole provider of both basic and optional coverages." However, given that the market for Optional Insurance is now competitive, ICBC must adhere to the standards of conduct imposed upon any dominant supplier of goods or services.

The Commission looks forward to grappling with the competitive issues that have been touched upon in this proceeding. While the Commission respects the desire and need for ICBC to hold certain competitive information confidential, the Applicant has a responsibility to disclose certain information which it might consider competitive information to allow the Commission and Intervenors to adequately test ICBC's applications, and to ensure competition in the provision of Optional Insurance is not thwarted.

1.4 The Regulatory Process

Section 45(1) of the Act requires the Commission to regulate ICBC's Basic Insurance business to ensure its operations are "adequate, efficient, just and reasonable." The Act further requires the Commission to ensure that the Basic Insurance business is not used to subsidize the Optional Insurance business, in order to encourage a fully competitive market in Optional Insurance throughout British Columbia.

The Commission typically executes its responsibility to regulate an applicant's business operations through written or oral hearing processes, or alternative dispute resolution settlements. The Commission and staff as well as interested Intervenors review the application and ask questions of the applicant that will aid in the decision-making process of a Commission Panel. The oral hearing process also allows a Commission Panel to quickly decide questions of relevance of either the data or a specific question after hearing argument from Intervenors or the applicant. A Commission Panel must decide what information it requires to make an informed decision.

For most regulated utilities, the Commission has the benefit of a long history of financial and operational data and past reviews of the integrity of management processes. This allows the regulatory process to focus on the important issues of the day rather than taking a great deal of time to determine whether an applicant is operating to industry standards. Reasonable business costs and cost controls are well established and understood by all participants. Departures from industry standards are quickly dealt with.

1.5 Regulation of ICBC

Regulation of ICBC is complicated by a number of issues, which have caused a temporary departure from the Commission's usual approach. First, ICBC has not, historically, operated its Basic and Optional Insurance businesses as two separate business lines. Thus, ICBC does not have many of the necessary accounting statistics required to easily assess its Basic Insurance cost structure or cost control processes. Also, ICBC has not provided the relevant data to compare its performance against industry standards for the delivery of the Basic Insurance business.

Second, ICBC enjoys a dominant position in the Optional Insurance market. Very little discussion has occurred with respect to what activities ICBC engages in or does not engage in which impact, either negatively or positively, the competitiveness of that market.

Last, due to the accelerated timetable required for the review of ICBC's 2004 Revenue Requirements Application ("Application"), a full oral hearing and review was not possible.

1.6 The ICBC Application

ICBC filed its first Application for 2004 Basic Insurance rates on August 29, 2003. Pursuant to Section 44 of the *Insurance Corporation Act*, and Sections 58 and 61(2) of the *Utilities Commission Act,* ICBC requested an increase of 1.3 percent applicable to Basic Insurance premium rate schedules for contracts effective on or after January 1, 2004.

In the Application, ICBC forecasts increases in uncontrollable costs such as premium taxes and the tariff used to compute legal costs for indemnification of successful litigants. ICBC stated it will absorb a portion of these increases by foregoing anticipated net income achieved through expense and claims control measures. The Applicant anticipates, however, that these measures will not enable it to totally avoid the need for an increase in Basic Insurance premium rates in 2004.

As a result of the timing of the legislation to bring certain aspects of ICBC operations under regulation by the Commission, ICBC was unable to complete its application prior to August 29, 2003. In discussions with Commission staff, ICBC identified that it required a decision of the Commission on the amendment to Basic Insurance premium rate schedules no later than November 17, 2003 to allow it time to implement new rates prior to the start of 2004.

Considering all of these circumstances and information, the Commission determined that a limited written hearing process was the appropriate vehicle for the review of ICBC's Application, and on September 2, 2003 issued Order No. G-54-03 setting forth the Regulatory Agenda and Timetable. The Regulatory Agenda and Timetable responds to the unique circumstances of this first review of ICBC's rates for Basic Insurance. However, the Commission expects to conduct much more extensive oral public hearings on a variety of matters during 2004.

1.7 The Written Hearing Process

The Commission recognized that the time available to it for a public review was constrained by the time when the Application could be filed with the Commission and the need to issue a decision no later than November 17, 2003. Recognizing these realities, the Commission established the limited written hearing process.

In this year's process, the public workshop held on September 11, 2003 was intended to be educational for all parties. The Information Requests submitted to ICBC on September 19, 2003 were intended to provide a means for the Intervenors and Commission staff to attain an enhanced level of understanding of the subject matter in the Application.

Following ICBC's response to the written information requests, Intervenors submitted their written evidence on October 3, 2003. That evidence presented the views of the Intervenors with respect to the substance of ICBC's Application. ICBC's final written argument was submitted on October 10, 2003. Intervenors presented their own final written argument on the merits of the Application on October 17, 2003. A final written right of reply was afforded to ICBC, which was exercised on Friday, October 24, 2003.

Although the public workshop assisted all parties in better understanding the ICBC Application, there were a significant number of information requests which were not answered as a result of ICBC submitting that they were not relevant to the hearing process or would divulge confidential competitive information. In addition, some information requests received responses which some Intervenors found to be inadequate.

The Commission Panel received several letters of complaint from Intervenors with respect to the perceived quality of the information responses. In responding to the complaints, the Commission Panel recognized that the timelines in this year's written hearing process were constrained for the purposes of allowing submissions to it on the appropriateness of individual information requests and the responses from ICBC. In Commission Letter No. L-50-03 to the Office & Professional Employees' International Union ("OPEIU") the Commission stated:

> First, the British Columbia Utilities Commission must act within the statutory mandates specified in the *Insurance Corporation Amendment Act, 2003, S.B.C. 2003, c. 35* and also in the *Special Direction IC1*, dated August 12, 2003. Issues to be considered by the Commission Panel must fall within this statutory mandate. For instance, this mandate does not cover ICBC Optional insurance.
>
> Second, due to the severe constraint to render a Commission Decision by November 17, 2003

and the resulting necessity of adopting the Written Public Hearing Process (Order No. G-54-03) for the examination of ICBC's 2004 Revenue Requirement Application, certain limitations are introduced that would not be present in a more comprehensive Oral Public Hearing process.

Third, the regulatory process is relatively new for ICBC and most of the Intervenors. We expect however, that over time ICBC and most Intervenors will become fully familiar with the process. Further, as ICBC restructures its operations to transition to a regulated environment, certain data is not available at this time.

The Commission Panel acknowledges the severe timelines for this year's review. However, the Commission Panel has received ample evidence to allow it to deal with the proposed rate increase for 2004 and comment on other significant issues to be examined further in future proceedings.

2 REVENUE REQUIREMENTS

2.1 Introduction

Premiums written are defined as the total premiums collected by ICBC upon the sale of a policy. The difference between total premiums written and total premiums earned arises due to accounting requirements where ICBC is deemed to earn premiums evenly over the term of a vehicle policy or driver penalty point year.

ICBC's independent actuary determined that the total premiums written for 2004 are likely to be $1,774,079,000 (BCUC IR 1.1.4.1). The actuarial estimate would require a 3 percent increase to existing Basic Insurance premium rate schedules.

However, ICBC is not asking for Commission approval of the actuarially indicated increase of 3 percent, but instead is requesting approval of a 1.3 percent increase to existing Basic Insurance rates for all contracts taking effect on or after January 1, 2004. This proposed increase would allow ICBC to recover the forecast 2004 total written premium revenue of $1,745,417,000 (Application, Tab 4, p. 4-3). ICBC proposes to recover the increased revenue through an equal percentage increase to all customers, hence there are no rate design requests in the Application.

ICBC submits that the 1.3 percent requested increase to existing Basic Insurance rates is required as it is driven by costs that are outside of its control. The first of these costs is the premium tax levied on all insurance policies and the second relates to the tariff of legal costs for the Supreme Court of British Columbia rules ("Court Tariff"). The increase in the premium tax, pursuant to the *Insurance Premiums Tax Act*, makes up .4 of the requested increase. The expected increase in the Court Tariff makes up the remaining portion or .9 of the requested increase. Both of these cost items will be discussed in greater depth in Sections 2.2 and 2.3 of this Decision, respectively.

2.2 Increase in Premium Tax

Under the *Insurance Premiums Tax Act*, all insurance companies operating in the Province of British Columbia are required to pay insurance premium tax to the Provincial Government.

In 2002 ICBC recorded $61,345,000 in premium taxes for the Basic Insurance program (Application, Tab 6, p.

6-3). For its 2003 Outlook period the Applicant projects premium taxes to increase to $65,846,000 as a result of growth in written premium. These taxes are forecast to further increase to $75,138,000 in 2004. The increase of $9,292,000 ($75,138,000 – $65,846,000) is mainly caused by the change in the premium tax rate, which will increase from the current 4 percent to 4.4 percent effective January 1, 2004. Section 15 of the *Budget Measures Implementation Act, 2003* (Bill 6 – 2003) amends Section 3 of the *Insurance Premium Tax Act* to provide for this increase. Bill 6 received Royal Assent on March 12, 2003 and Section 15 is brought into force on January 1, 2004 (BCUC IR 1.1.6.1).

Intervenors were generally silent on this issue. The OPEIU stated that " the increased tax level on premiums from 4 percent to 4.4 percent and resulting 0.4 percent increase is unavoidable in our view…" (OPEIU Submission, p. 5).

The Commission Panel finds that this cost increase is certain and therefore approves the 0.4 percent increase to Basic Insurance rates.

2.3 Increase in Court Tariff

2.3.1 Background

This issue deals with the anticipated increase in the Court Tariff, which will impact upon the legal costs that ICBC is required to pay to successful litigants.

On the issue of the probability of the increase and the timing thereof, Eckler Partners state: "There is a possibility of an increase during 2004 in the tariff used to compute the Party-and-Party costs for indemnification of successful litigants. We have assumed that an increase in the tariff will impact the entire 2004 policy year. In 1990, the Supreme Court of British Columbia set out its intention to reimburse the successful party for 50 percent of its legal fees. A schedule of tariffs was established at that time to provide that intended level of indemnification. However, over time the actual costs tend to increase because of inflationary and other pressures, while the tariff remains unchanged unless the Supreme Court revises the schedule. Since 1990, there has been only one change to the schedule, that being in 1998. The Supreme Court, through its Rules Revision Committee, has asked for submissions by November 2003 relating to revision of the tariff schedule" (Application, Tab 5, Section 5.3.4).

ICBC has recorded adjusted claims reserves for 2003 and prior years in the 2003 Basic Business Statement of Operations, filed with the Application, to reflect the cost of the anticipated increase to the Court Tariff. The Application states: "The impact of these additional legal costs on existing litigated claims was also considered. A $14.6 million adjustment to current year's claims and a $47.6 million adjustment to prior years claims for the basic business was recorded to adjust the unpaid claims reserves for the impact of the Tariff. ICBC believes it is prudent to make this adjustment in 2003, in the event that these higher legal costs are applied retroactively to claims already in the litigation process" (Application, Tab 6, p. 6-2).

The anticipated impact on 2004 claims and corresponding treatment in the Application is stated by Eckler Partners as: "If the revision becomes effective during 2004, then it is quite likely that all third party liability claims on policies written in 2004 would be subject to the effect of the change in the tariff schedule. Based on discussions with ICBC claims staff, we selected a 75% probability of there being a change in the tariff schedule. This lead to the estimated cost for policy year 2004 of $27.6 million ($36.8 million x 75%)" (Application, Tab 5, S. 5.3.4). This estimated cost category appears in the Basic Business Statement of Operations at Tab 4, page 4-3, Figure 2 of the Application and the amount is recorded as $20.211 million. In its Final Submission ICBC references the $27.6 million and describes further: "The impact on the Basic business for 2004 is $20.2 million" (ICBC Final Submission, p. 5).

The claims reserving actions taken by the Applicant in anticipation of the Court Tariff increase will result in a net positive claims adjustment for claims subject to the Court Tariff as they are settled prior to the effective date of any change to the Court Tariff. This will result in 2004 net income which will exceed the established target in the Special Direction. However, depending on if, when and how the Court Tariff change is implemented, that net positive claims adjustment booked in 2004 could offset some or all of the need for revenue to support an increase in Court Tariff related claims reserves for 2004 claims.

2.3.2 Intervenor Views

Intervenors, with the exception of the OPEIU, did not specifically comment on the issue of the Court Tariff increase. The OPEIU stated: "The increase for legal tariffs application is premature" and "We submit that the Commission must dismiss it because it is based on speculation." The OPEIU further submits "that there is already a 'reserve' in the Government requirement to target a profit figure of $36 million that can bridge any unknown cost increases for the period necessary to make a new application to the BCUC. The profit can be for no other purpose, as this Corporation is non-profit in nature and mandate" (OPEIU Submission, pp. 4-5).

2.3.3 Commission Panel Determinations

The Commission Panel accepts the position taken by ICBC in the Application to make Court Tariff related adjustments to current and prior years' claims reserves in 2003. **The Commission Panel directs that that portion of the claims reserves for 2003 and prior years which reflects the anticipated Court Tariff increase ($14.647 million plus $47.601 million equals $62.248 million) be moved to a separate reserve account.**

However, the Commission Panel recognizes that there is significant uncertainty surrounding the possible approval of a new Court Tariff, whether it will apply to claims initiated prior to its implementation and how much the increase may be. Given all of these uncertainties, the Commission Panel determines that the $62.248 million transferred to the separate reserve account is likely sufficient to fund the incremental impact on 2004 claims of any change in Court Tariff in 2004, as well as 2003 and prior years claims. If ICBC wishes to create a separate reserve account for the potential impact on 2004 claims of a change to the Court Tariff, it should draw down the separate reserve account to fund the 2004 reserve for the 2004 claims [i.e. the 2003 separate reserve account would be reduced to $42.037 million ($62.248 million - $20.211 million) and a 2004 reserve account of $20.211 million would be established]. Alternatively, the separate reserve account of $62.248 million could remain as a single account to recognize the potential impact of a Court Tariff change to fiscal years 2004, and before. **The request for a 0.9 percent rate increase in Basic Insurance rate schedules for 2004 claims reserves is, therefore, denied. The separate reserve account balances (either positive or negative) at the end of 2004 would be factored into any rate change in subsequent years.**

2.4 All Other Costs

The forecast of all other costs for 2004 equates to $1,779,266,000 (excluding premium taxes and Court Tariff impact). The various components comprising the forecast of all other costs are shown in the following schedule, segregated into controllable and other categories (2003 Outlook and 2002 Actual amounts are provided for comparison).

Particulars	($000's)	($000's)	($000's)
	2004	2003	2002
Controllable Other Costs			
Claims Services	143,882	140,617	135,637
Road Safety Expenses	43,096	42,128	34,940
Insurance Operating Expenses	80,693	75,140	70,843
Non-Insurance Expenses	88,177	85,961	83,397
Subtotal	355,848	343,846	324,817
Other Costs			
Claims Incurred	1,373,006	1,354,572	1,308,497
Prior years' claims adjustment	--	(28,841)	(10,664)
Commissions – Insurance	34,412	26,906	14,845
Commissions – Non-Insurance	16,000	16,000	15,427
Subtotal	1,423,418	1,368,637	1,328,105
Total Other Costs	**1,779,266**	**1,712,483**	**$1,652,922**

2.4.1 Controllable Other Costs

ICBC established the 2002 costs of $324,817,000 as a base. Furthermore, the Applicant states it is committed to maintaining this base for controllable costs into 2003 and 2004 and will only increase it for identifiable and justifiable cost changes (ICBC Supplementary Response, October 1, 2003, p. 2). ICBC chose 2002 controllable costs for the base since they reflect significant reductions that occurred over the two year period to the end of 2002. During this period, the Applicant streamlined business processes, eliminated business functions, reduced staffing levels by 1,350 full time equivalent positions, realized savings in facilities and vehicle service costs, and reduced discretionary spending.

For 2003 these base costs are projected to increase by $19 million to a total of $343,846,000. The increase is required for road safety enforcement, contractual salary agreements, pension surplus amortization changes, inflation and regulatory costs. For 2004 these costs are forecast to increase by an additional $12 million to a total of $355,848,000. This increase is required for similar reasons as for 2003 (ICBC Supplementary Response, October 1, 2003, p. 3).

2.4.2 Other Costs

ICBC states that forecast 2004 claims incurred costs represent the actuarial estimate of the cost of settling claims for crashes expected to occur during the 2004 calendar year.

Commissions (a flat fee is paid for services rendered) are paid to brokers for the sale of the Basic Insurance product, and for driver and vehicle licensing transactions.

2.4.3 Intervenor Views

Many Intervenors expressed concern with ICBC's forecast of all other costs for 2004, largely due to the apparent lack of supporting detail.

British Columbia Old Age Pensioners' Organization *et al* ("BCOAPO") expresses concern that the lack of detail in respect of the 2004 forecast as a whole does not provide information sufficient to conclude that the requested rate increases are necessary (BCOAPO Final Argument, p. 5).

HSBC Canadian Direct ("HSBC") takes issue with the use of the 2002 cost data as a baseline. It states that "any short term view of trends is not informative and, we submit, invites the wrong conclusions" (HSBC Final Argument, p. 1).

The OPEIU focuses on concerns it has about management compensation increases and "Pay for performance" initiatives. The OPEIU states that "management compensation at ICBC has been out of control since 1998," "bonuses are new to the Corporation and also appear out of control" and "given the serious nature of these increases on the surface and the lack of responsiveness, we request full review and disclosure" (OPEIU Submission pp. 3-4).

The British Columbia Chiropractic Association ("BCCA") focused its efforts on reviewing ICBC's management of health care costs and submits that "the BCCA believes the corporation's policies and their implementation are not achieving lowest costs" (BCCA Submission, p. 3).

The British Columbia Automobile Association Traffic Safety Foundation ("BCAA") appears to support ICBC's activity and expenditures for Road Safety Programs by stating that ICBC is making significant contributions in improving road safety conditions throughout British Columbia and that road safety partnerships are effective and are contributing to a reduction in road crashes (BCAA Submission, p. 1).

2.4.4 Commission Panel Determinations

The Commission has a responsibility for ensuring that ICBC offers Basic Insurance service to its customers that is "adequate, fair, efficient and just." In order to discharge its responsibilities in this matter the Commission expects to examine revenue requirements for reasonableness and to compare ICBC's costs against industry standards. Just as importantly, however, the Commission looks at management and its ability to either generate additional revenue and/or lower costs. The Commission looks for appropriate governance processes as well as management's focus on cost control. In today's market, innovative thinking is required to provide better service quality to customers as well as lowering the overall cost. The Commission will not try to manage the business but it does assess the processes management has put in place.

The Commission Panel recognizes that ICBC cannot fully control many of its costs such as frequency and severity of accident claims, the general rise in health costs and jury awards and weather impacts. This lack of full control cannot, however, be used as an excuse for lack of performance improvement. All industries, to varying degrees, face a lack of control over important factors in their business. Company performance measures allow the Commission to judge the progress that management is making in improving both the efficiency and quality of service provided to the public.

Following are some questions the Commission has with respect to the operations of ICBC. This list is by no means exhaustive but is provided to give guidance to ICBC in preparing future rate submissions. It should be noted that while there are numerous references in the Application to "continued emphasis on expense control," the Commission Panel found few specifics and little evidence to judge ICBC's performance on these matters against industry standards. The Commission will expect a more fulsome disclosure in these and other areas during the Corporation's next full rate review.

- ICBC has provided some evidence concerning its Road Safety and Loss Management programs. The Commission would like to see additional evidence on ICBC's process to determine the effectiveness of these programs. For example, criteria for investment, monitoring programs for effectiveness, etc. HSBC notes this dilemma in its final argument by highlighting the importance of the fraud "zero tolerance" policy and noting the lack of outcome data.

- ICBC notes health costs are rising generally but does not offer details of its cost management program. For example, what buying opportunities are being exploited? How is ICBC using its buying power to establish contractual relationships with the private sector to lower costs? What technology improvements are being pursued to lower costs?

- On a similar note, ICBC is concerned about rising legal costs. What programs are being pursued to lower these costs, speed the court process, use alternative dispute procedures, weigh the cost of litigation vs. settlement, etc.? How is ICBC motivating parties (including lawyers) to settle to avoid court processes?

- While some technological advances and e-business capabilities have been noted in the Application, this area is constantly changing. What opportunities are available to reduce distribution and service costs? It is also an area of significant risk of over-spending and/or under-delivering. The potential for an expensive technical fault is a major concern. What programs are in place to ensure ICBC gets maximum benefit from its information technology spending as well as protecting its investments and customers?

- The Application provides some basic data in general areas of spending but very little explanation of year-over-year changes. For example, acquisition costs rose 22 percent between 2002/2003 without a detailed explanation of why. What programs will be pursued as a result of the trend, or is it a one-time event?

- ICBC has undertaken a pay-for-performance compensation system. What corporate measures (with comparable industry standards) are being pursued to dovetail with this program?

The Commission Panel accepts the 2004 forecast of all other costs for the purpose of completing the 2004 revenue requirements Decision. It also directs ICBC to provide much more rigorous and extensive evidence in support of any costs included in its future rate applications to the Commission. The Commission Panel strongly encourages ICBC to consider the kind of questions articulated above when preparing that supporting evidence. Chapters 6 and 7 of this Decision also provide additional direction to ICBC with respect to Commission expectations for future submissions.

2.5 Premium Revenues and Investment Income

2.5.1 Premium Revenues

ICBC derives premium revenues for its Basic Insurance line of business from the following sources (Application, Tab 7, p. 7-1).

- Vehicle premiums paid by customers for the Basic Insurance product. These also include fees and surcharges associated with certain types of transactions. Vehicle premiums comprise almost 99 percent of all premium revenue collected by the Corporation.

- Driver premiums collected from individuals with driving infractions. These premiums are based on the number of penalty points incurred by these individuals.

Vehicle premium revenues written continue to increase, and are primarily driven by increases in the number of policies written and changes in rates. The increases in the number of annualized policies written (which are a function of increases in vehicle population growth) in 2002, projected in 2003 and forecast in 2004 are 1.4 percent, 1.5 percent and 1.8 percent, respectively (BCUC IR 1.2.4.2). Basic Insurance rates were increased by 6.6 percent in 2002 and 2.1 percent in 2003 (Application, Tab 7, p. 7-2).

Vehicle premium revenue written, at existing rates, for 2004 is forecast at $1,705,000,000. In response to BCUC IR 1.2.2.3, ICBC reported an amount of $1,723,000,000 for 2004 estimated premiums written, at existing rates. This amount includes $18,000,000 for driver premium revenue written. The portion of vehicle premium revenue written would then equate to $1,705,000,000. By comparison, vehicle premium revenue written for the Outlook 2003 is projected at $1,665,811,000 (Application, Tab 4, p. 4-3). The actual vehicle premium revenue written for 2002 was $1,587,186,000 (Application, Tab 4, p. 4-3).

Most Intervenors did not take issue with ICBC's 2004 growth forecast of 1.8 percent related to the number of policies written and the resulting forecast of 2004 vehicle premium revenue written. HSBC noted that in addition to vehicle growth and rate changes, other factors (perhaps Principal Operator or some other factor not explored by ICBC), appear to be contributing to Basic Insurance premium revenue increases (HSBC Submission, p. 2).

The Commission accepts the 2004 forecast of premium revenue for the purpose of completing the 2004 revenue requirements Decision.

2.5.2 Investment Income

The lag between the time when premium revenues are collected and the time that ultimate claims costs related thereto are paid out, provides funds which are available to ICBC to invest in various fixed income and equity instruments on behalf of policyholders. The income earned from these investments is usually a significant component in the determination of the Corporation's overall Basic Insurance revenue requirement and serves to mitigate premium rate increases.

For 2004, investment income is forecast at $212,902,000 and equates to an overall yield of 5 percent for ICBC's investment portfolio (Application, Tab 7, p. 7-4). The 2004 forecast amount increased from the projected investment income of $203,946,000 for Outlook 2003 due to expectations of increased returns on equity investments and a decrease in returns from short and long-term fixed income investments. The components of forecast investment income for 2004 are $2,356,000 ($4,742,000 in 2003) from short-term fixed income investments, $141,455,000 ($195,080,000 in 2003) from long-term fixed income investments and $69,091,000 ($4,124,000 in 2003) from equities (BCUC IR 1.3.2.1).

The investment portfolio that generates the investment income is governed by ICBC's formal investment policy, which is based on the standards set out in legislation. Section 29 of the *Insurance Corporation Act* and Section 2 of the Application of Legislation Regulation, B.C. Reg 322/03 deposited, sets out the specific statutory framework and asset class limits with respect to ICBC's investments (BCUC IR 1.3.1.2). The Corporation's Chief Financial Officer is charged with the responsibility for monitoring ICBC's investment activity to ensure compliance with stated policies and procedures. Any violation is reported to the Investment Committee of the Board of Directors.

Intervenors did not specifically comment on the reasonableness of ICBC's forecast of investment income for 2004.

The Commission Panel accepts the 2004 forecast of Investment Income but notes that investment income is an extremely important part of ICBC's business. While ICBC has multiple professional investment managers, there is very little evidence about ICBC's governance procedure and how ICBC is managing its costs and risk exposure in this area. With "late trading" scandals in the news and historically low fund returns, the Commission Panel directs ICBC to include additional information in its next revenue requirements application to demonstrate the asset safeguards that are in place and any incentive plans that ICBC has negotiated with its investment managers.

2.6 Stable Rates

In the Application and in correspondence through the hearing process, ICBC speaks to specific objectives related to insurance rates and rate increases. ICBC states “By keeping its claim costs down through such initiatives, ICBC can further its objective of keeping rates low and stable for consumers.” ICBC continues “Overall, in terms of future direction, ICBC recognizes its obligation to keep rates at their lowest levels possible…ICBC will pursue a strategy of fair and reasonable incremental rate increases to address rising costs so that volatility in rates may be avoided” (Application, Tab 1, pp.1-4, 1-5). In its Final Reply ICBC again addresses the issue of rate increases: “The Corporation will address rate design in future proceedings, but implementation of changes must be undertaken in a manner that avoids rate shock and other significant impacts on customers.”

Section 45(1) in the Act requires ICBC to “make available universal compulsory automobile insurance in a manner, and in accordance with practices and procedures, that the commission considers are in all respects adequate, efficient, just and reasonable.” The Commission is of the view that rate stability and fair and reasonable incremental rate increases are important criteria in meeting this performance requirement. It appears to the Commission Panel from evidence advanced that ICBC and many of the Intervenors share this point of view.

This view might support the position that small and regular increases in premium provide a stream of increasing earned premium per policy with which to pay for projected but yet to be fully defined increases in claims and operating expense. Such a practice avoids premium volatility and assures that the premium base is there as costs increase. A counter argument can be made that increasing premiums are not inevitable. In the absence of the natural forces of a competitive market place, the temptation to increase rates to offset potential cost increases and to condition the public to escalating rates may create a dangerous precedent. While the Commission Panel agrees that reasonable incremental rate increases are preferred over a sudden large increase, the best outcome would be cost mitigation and no increase at all - in other words, rate stability. Every effort must be made, and be seen to be made, to contain costs. When a cost is presented in a rate request for approval of a rate increase, causation must be identifiable and defendable.

The Applicant makes reference to other issues which could impact net income and therefore impact on rate requirements. “Significant cost and income items such as claims incurred and investment income are heavily influenced by external factors, and deviations from expected results would have a significant impact on net income. A one percent change in claims incurred would result in a $14 million change in net income and a one percent change in investment return would result in a $43 million change in net income" (Application, Tab 4, p. 4-2).

These factors have the potential to overwhelm the target net income of $36 million, positively or negatively, irrespective of prudent and capable management of the operations of the business. In the absence of designated capitalization to absorb the impact of unexpected and significant cost and income variances and blending this result into rates over time, rate volatility year to year could be significant.

In its decision, the Commission Panel accepts the assumptions of the Applicant with respect to investment income and claims incurred and therefore did not factor in the possibility of a negative or positive result thereof on the net income target of $36 million.

3 INDICATED RATE LEVEL CHANGE

3.1 Introduction

ICBC advances two methodologies for the purpose of setting 2004 Basic Insurance Rates. The methodologies and rationale are described as follows:

> For the purposes of setting 2004 basic rates, there is a legislated requirement for ICBC to achieve the Service Plan target of $36 million in fiscal 2004. For this reason, this application has been prepared to reflect both the actuarial perspective, which is the industry standard, as well as the accounting perspective in order to address legislative requirements.
>
> An actuarial approach to rate level requirements indicates a 3.0% rate increase is required for policy year 2004. To maintain consistency with the agreed net income target, ICBC has based the rate submission request on an accounting year approach for this transition year (Application, Executive Summary, p. vi).

The methodology on which the Application is based is further described as "…a blended actuarial and accounting approach to achieve the net income target specified in the Special Direction" (Application, Tab 2, p. 2-2).

3.2 Actuarial Rate Level Requirements

These submissions attracted information requests from both the Commission staff and Intervenors. ICBC referred to the indicated premium increase of 3.0 percent, on a number of occasions, as a reference point with which to compare the requested increase of 1.3 percent as determined by the accounting method.

The Applicant did not use the actuarial method to justify its rate request. The rationale is that "…ICBC is able to achieve the legislated requirement with the proposed rate increase, which is below the actuarial rate level requirement (indication). Requesting a rate increase equal to the actuarial rate level requirement would result in a 2004 net income, which exceeds the target" (Application, Tab 4, p. 4-1). The indicated net income in 2004 after the impact of the Court Tariff using a 3.0 percent increase in premiums as indicated by the actuarial method, is $54.678 million. This compares to a requirement by Special Direction of $36.0 million. In further discussing the implications of not using the indicated revenue result of the actuarial method ICBC states: "By requesting only a 1.3% increase and not the full actuarial indication of 3.0%, ICBC's basic business will be revenue deficient in policy year 2004" (ICBC Final Argument, pp.8, 9). This analysis highlights the differences between the two methodologies.

3.3 Intervenor Views

The submissions by Intervenors did not provide substantive discussion of the actuarial approach to ratemaking or the substance of the Eckler Report. Intervenors may have set aside the report, since ICBC was not relying on it directly to support its request for a 1.3 percent rate increase. In addition, Intervenors have recorded their frustration with ICBC maintaining data on a confidential basis, which has impeded Intervenors from fully testing the findings of the Report. The BCOAPO states that:

> The approach of BCOAPO *et al.* to determining whether or not a rate increase would be needed in order to meet the $36 million target was twofold. First, we attempted to examine the underlying details of the 2004 forecast. Second, we attempted a global review of historical results. Both approaches were, of course, dependent upon the provision of information by ICBC that would be sufficient to demonstrate that the rate increase would be necessary. It would have been in ICBC's interests to provide this information, given that the onus is on ICBC to demonstrate the need for the rate increase. As will be seen, however, neither approach actually resulted in the production of information that could demonstrate the need for the proposed rate increase (BCOAPO Argument, p. 5).

3.4 Commission Panel Determinations

The Commission Panel understands the role that the actuarial methodology plays in determining revenue requirements over successive years. It is also sensitive to the desire for rate stabilization and avoidance of "rate shock." The Commission Panel therefore accepts the position of the Applicant that: "It is ICBC's intent that future rate applications will be based upon the actuarial methodology of determining rate level requirements. This will allow ICBC to manage the basic business, such that policyholders enjoy a rate environment where rates will be smoother and more stable over time" (ICBC Final Argument, p. 9).

The actuarial methodology, if used as the basis for the 2005 revenue requirement application, will no doubt be the subject of detailed questions on the underlying assumptions. If this methodology is to be used effectively, the underlying assumptions will require clear and supportable data and full disclosure.

The Indicated Rate Level Change, based on actuarial methodology and reflecting policy year rather than accounting year financial outcomes was not relied on to support the Application.

4 CUSTOMER SERVICE AND CORPORATE PERFORMANCE

Service quality is a key component in the measurement and/or perception of value received by the end user of a product or service. With insurance being costly and necessary, but an intangible product, the convenience of purchase and service rendered in the purchase process, clarity of documentation and ease of access for information are some of the measures of value perceived by the purchaser. In other cases when a claim is made, ease of access and convenience, level and style of service and satisfaction with the outcome will, to a great degree, leave an impression of value received. In the regulation of a monopoly service provider it is important to ensure that the ratepayers receive high quality service, delivered efficiently by the monopoly.

4.1 ICBC's focus on Service Quality and Corporate Performance

ICBC recognizes the importance of customer service in the Annual Report filed as part of its Application. That report contains reference to Customer Satisfaction levels for 1999 through 2002. In its report on performance in the Annual Report, ICBC states: "Once direction is set and goals established, the key to success is the measuring and monitoring of results towards those goals. For 2002, ICBC set out to:

- better understand the customer;
- achieve operational excellence;
- become financially sustainable;
- shift to a performance culture; and
- invest in cost effective loss management initiatives" (Application, Appendix A, p. 37).

ICBC identifies seven financial indicators and states that it is performing well against each indicator. The Annual Report identifies two additional indicators (injury frequency and customer satisfaction). The Corporation also proposes two other indicators related to auto crime rates and a customer-confidence index.

ICBC also addresses quality of service and performance measures in its Service Plan which was included in the Application at Appendix B. The section with respect to Strategic Goals, Objectives, Strategies and Performance Measures sets out a road map of the four corporate goals that ICBC believes it needs to succeed in to achieve its vision of being the leading insurance company in all aspects of its business, operating competitively and valued by its customers. With respect to the corporate objective of becoming more competitive, ICBC defines its objective to "…deliver innovative, competitive and tailored optional insurance products and services that are valued by customers, self-funded and priced based on risk" (Application, Appendix B, p. 19). Three performance measures focus on the return on equity and the overall profitability of the Corporation.

The corporate goal of being customer focused has the objective to "increase customers' support for ICBC as a result of informed opinions and a better understanding of the value and operations of the company" (Application, Appendix B, p. 21). Four performance measures focus on the satisfaction of customers with their experience with ICBC.

The corporate goal of being revenue driven and fiscally responsible is supported with the objective to excel in operational effectiveness and efficiency, to minimize claims costs, severities and frequencies through claims and loss management and road safety, and to reduce the cost of goods and services purchased and increase the recovery costs for services provided (Application, Appendix B, p. 24). This goal is supported by eight performance measures related to cost containment, and auto crash statistics.

A human resources goal of being personally accountable, capable and engaged people has the objective to "develop a high performance work culture that enables people to succeed in a competitive environment" (Application, Appendix B, p. 29). The performance measure in support of this goal is the employee index. This is a new performance measure which is based on survey results with respect to employee alignment and employee engagement.

4.2 Intervenor Views

Those Intervenors which addressed the ICBC performance measures with respect to service quality and corporate performance did so indirectly. For example, the BCOAPO recommended benchmarking of ICBC's performance with that of other public insurance companies. The BCCA focused its information requests and submissions on the potential benefits that could accrue to the public and ICBC through a more proactive analysis of health services. Pemberton Insurance Corporation ("Pemberton") addressed this issue in its argument in defining the regulatory interests to include the customer, government, providers of Optional Insurance products, ICBC employees, and suppliers or contractors. Pemberton reflects on the customer interest to state "the customer does not want to be gouged, nor do they want to starve the organization of revenues which would create deterioration on the level of service" (Pemberton Final Argument, p. 7).

In addition to the indirect evidence of Intervenors, the record of this proceeding includes questions with respect to the efficiency of various road safety programs. ICBC identified that at least some programs are supported by business cases and that financial hurdle criteria may exist.

4.3 Commission Panel Determinations

Overall customer satisfaction is an amalgam of the service received compared to service expectations in all interactions with ICBC (including its agents and affiliates). While it is not practical to monitor and report on service results for all customer contact points, there will be key reporting points critical to the achievement of desired customer satisfaction levels. These reporting points form the basis of important management performance reports and from a regulatory point of view must be the focus of corporate commitments to service levels that correspond to an approved rate schedule.

While it is not possible to make direct use of past Commission practices in respect of corporate performance in similar industries, the Commission Panel is of the view that ICBC could receive guidance by examining the types of corporate performance programs that have been put in place by the Commission. By way of example only, ICBC is referred to the productivity factors and Service Quality Indicators ("SQIs") that were applied to Terasen Gas Inc. in the context of a multi-year, performance-based Rate Plan (Commission Order No. G-51-03, July 30, 2003).

As the regulatory scrutiny afforded the Corporation by the Commission matures over time, the Commission Panel is of the view that there ought to be means for measuring the performance of the overall corporation and how it changes. This will certainly involve a continuing analysis of customer service and the perceptions that policyholders have of their treatment, but it goes further. In any well-run enterprise, there must be performance targets established against which operations can be evaluated. In the view of the Commission Panel, this is particularly important for a monopoly auto insurance business where single-year performance may give a distorted image of the real performance of the business over the long term.

The Commission Panel is encouraged by the statements by ICBC in the evidence to the effect that "Specific measures and targets are in place that allow ICBC to monitor its progress in this area of [customer service]" (See for example, ICBC's Final Submission, p. 6, the Annual Report 2002, pp. 42-43 and the Service Plan, pp. 20-23). There is also recognition that measures of total corporate performance are required if the enterprise is to be managed effectively. The Commission Panel would add that such measures are also a requirement if the Commission is to adequately discharge its regulatory mandate.

On the other hand, the Commission Panel recognizes that it is not the responsibility of the Commission to micromanage the operations of ICBC and that the board and management of the Corporation must have the operational flexibility to conduct the affairs of the Basic Insurance business line as they best judge in the interests of the Corporation, its shareholder, employees and the policyholders. There is balance to be maintained. The courts have opined on just how that balance should be maintained:

> *"Section 29 of the Utilities Act has some relevance to the contention that the Integrated Resource Planning process comprises in one bundle the exercise of individual powers granted the Commission. It directs the Commission to make examinations and conduct inquiries necessary to keep itself informed about, amongst other things, the conduct of public utility business**. It does not authorize the Commission to direct how that business is conducted."*** (See BC Hydro and Power Authority v. BC Utilities Commission *et al*, Court of Appeal for British Columbia, February 23, 1996 emphasis added.) [Note: Section 29 of the *Utilities Commission Act* does not apply to ICBC but the Court's guidance is of relevance to the regulatory scrutiny of the Corporation by the Commission.]

The Commission looks forward to working with ICBC to better understand the performance measures that the Corporation has in place now and the measures it intends to adopt for the future. In particular, the Commission will want to examine the make-up of the newly adopted "Customer Approval Index" and to assess whether it provides the easily measured metrics that will be key to establishing and understanding the trends that make up long-term performance.

There is a wealth of literature on the issues involving total corporate performance but the Commission Panel is of the view that management of the Corporation is best positioned to select a methodology that will meet internal corporate needs as well as satisfying the Commission that there are corporate metrics available that will allow the Commission to chart the performance of ICBC over time.

The Commission Panel notes the information request of the BCCA concerning "outcome or performance based measurement criteria when implementing injury claim measurement policies to contain health costs" (BCCA Evidence, September 19, 2003, p. 2). ICBC responded to an earlier Information Request from BCCA that it did not manage medical costs *per se* but relied upon managing overall bodily injury claims cost (BCCA IR 1.10). The Commission Panel is of the view that more granularity in the tracking systems for medical costs would serve the Corporation and the Commission better than aggregated results. This seems to be within the capability of existing management systems as ICBC notes in response to BCCA, that it is possible to track the services provided by various types of practitioners (BCCA IR 1.17). The Commission Panel cites this as but a single example of the types of metrics that would be helpful in developing a set of measurements that would monitor corporate performance in critical cost areas.

In respect of medical costs alone, the Commission will be interested to hear ICBC's views as to how active it ought to be in monitoring medical costs with a view to reducing costs while still providing adequate levels of customer service. It may well be that a corporate comparison could be made in this area between the management activities of ICBC and other entities such as workers' compensation boards and private disability insurers.

Similarly, ICBC responded to HSBC that it does not track claim services expenses attributed to each reported claim, relying on a cost allocation approach (HSBC IR 1.1). The Commission Panel believes that for marginal expenditures in systems improvement, it may be possible to track individual claim service costs. This would have an obvious benefit in ensuring that there is no cross-subsidization between the Basic and Optional Insurance lines of business.

There may also be innovative ways of displaying the trends in claims costs. For instance, one possibility is the development of a Claim Settlement Efficiency Index that would be the ratio of Average Claim Service Cost to Average Claim Size. If this index were rising, there would be good grounds to see if settlement procedures were adequate, or if there was some other factor at play that was causing the decrease in efficiency. Here again, the Commission will look forward to the metrics that are developed by ICBC to satisfy internal and regulatory requirements.

The Commission Panel notes that the Performance Management Incentives granted to management and confidential (non-unionized) staff, are tied to specific corporate performance targets. While the total compensation paid to any one individual or class of individuals will not receive the attention of the Commission, the fact that compensation is the largest single cost beyond claim settlement cost demands that this area receive some regulatory attention. The Commission will want to assure itself that the performance parameters that drive total compensation for all employees (including any for unionized staff), are reasonable and that there is no conflict between the parameters used for compensation and those that are used to track total corporate performance for regulatory purposes. While ICBC is of the view that comparisons with other public insurance companies requires adjustments for the differences in products and environments (ICBC Final Reply, p. 17), the

Commission Panel believes that in the area of total compensation, meaningful comparisons could be made with other public insurance companies and with private sector companies with similar product complexity and size.

The Commission Panel was pleased to note that many ICBC corporate initiatives are subjected to business case evaluations (See for example, the response to HSBC IR 1.12 in which ICBC noted that the "Express Repair" program passed a business case examination). The establishment of reasonable assumptions in the business planning process (i.e. the discount rate for NPV analysis, payback periods etc.) would buttress any argument that the Applicant may want to present to the Commission in terms of its stewardship of the monopoly mandate that it has for Basic Insurance. The Commission would be pleased to learn what follow-up action is taken to monitor the actual results of approved programs.

In conclusion, the Commission Panel is encouraged that the Corporation is placing significant importance on the measurement of customer service and overall corporate performance and as the regulatory environment for ICBC develops over time, it is expected that there will be comprehensive metrics available to the Commission and other interested parties that will ensure a meaningful review of the operations and practices of the Corporation.

5 FINANCIAL ALLOCATIONS

The allocation of shared costs and revenues between the two separate lines of business of ICBC is a major responsibility for the Commission in support of the Government's desire to encourage competition in the provision of Optional Insurance. The Commission recognizes that the potential competitors must be assured that the allocation of costs between Basic and Optional Insurance is done in a fair manner which will ensure that all parties competing in the provision of Optional Insurance are doing so on a level playing field.

Division 3 of the Act addresses the issues related to competition regulation. In particular, Section 49 deals with the separation of businesses and reads as follows:

> **Separation of businesses**
>
> 49 (1) The commission must ensure that the universal compulsory automobile insurance business and the revenue of the corporation, other than revenue from the corporation's optional automobile insurance business, are not used to subsidize the corporation's optional automobile insurance business.
>
> (2) For the purpose of subsection (1), the commission may issue any orders it considers necessary to ensure that the corporation's optional automobile insurance business and activities are segregated from the corporation's other businesses and activities for accounting purposes, and that, in addition, any other businesses and activities of the corporation that the commission considers appropriate are segregated from the remaining businesses and activities of the corporation for accounting purposes, including, without limitation, orders
>
> (a) requiring reports from auditors,
>
> (b) requiring reports from actuaries, and
>
> (c) specifying cost allocation practices and other accounting practices that the corporation is to follow.
>
> (3) Before taking any action under this section, the commission must consider any current reports ordered under subsection (2) (a) or (b).

5.1 ICBC's Application

Appendix C to the ICBC Application details the Corporation's financial allocation methodology. ICBC asserts that many revenues and costs associated with Basic and Optional Insurance business can be directly attributed to each business and do not require allocation. The Basic Insurance business costs can be further divided between Basic Insurance and non-insurance services. ICBC's shared common services help it to take advantage of its economies of scale and scope, avoid costly duplication of effort, and maintain the lowest rates possible for consumers.

ICBC considered two fundamental approaches to the allocation of shared costs and selected a "pro-rata" approach. The pro-rata approach allocates revenues and costs to each line of business based on the drivers of those revenues and costs, and the degree of causality. ICBC also considered allocating the majority of costs to the Basic Insurance business and applying incremental costs related to Optional Insurance activities to the Optional Insurance line of business. It argues that ICBC is mandated to provide Basic Insurance and since the Corporation is required to provide Basic coverage, it might be logical to first allocate costs to the business which it must operate. However, the Applicant acknowledges that an incremental approach, by its very nature, will bias the allocation to one business line or the other and, therefore, it has determined that the pro-rata approach is more objective, reasonable and consistent with legislative objectives (ICBC Final Argument, p. 11, Application, Tab C, p. 3). ICBC asserts that the pro-rata approach results in a greater allocation of costs to Optional Insurance than the incremental approach.

For each major revenue or cost area, ICBC undertook an allocation process for the shared costs. Where there is a direct link from revenues or costs to Basic Insurance, Optional Insurance or non-insurance functions these costs were "directly attributable." Where revenues and costs were not directly attributable, causation was used to determine the appropriate basis of allocation. The four methods of allocation were work effort, premiums written, claims incurred, or shared services.

ICBC asserts that its allocation methodology is consistent with generally accepted accounting principles, consistent with the National (U.S.) Association of Insurance Commissioners ("NAIC") Issue Paper, consistent with the guidelines laid out by the Insurance Bureau of Canada Expense Allocation Program and consistent, where appropriate, with the bases of allocation used within the Public Automobile Insurance Industry of Canada (Application, Tab C, p. 4).

ICBC used its 2002 audited statement of operations as the test year on which to apply the allocation methodology. The results of the allocations between Basic and Optional Insurance are tabulated on page 12 of the Financial Allocation Methodology Study (Application, Tab C).

5.1.1 Premium Revenues Earned

Ninety-seven percent of the net vehicle premium revenue is directly attributed between Basic and Optional Insurance services. The remaining 3 percent of revenue consists of general fees and surcharges which were allocated based on overall insurance premiums earned, since they generally followed the overall volume of insurance premiums in each business. Driver premium revenues generated from penalty points were directly attributed to Basic Insurance as required by Section 2(5) of the Special Direction.

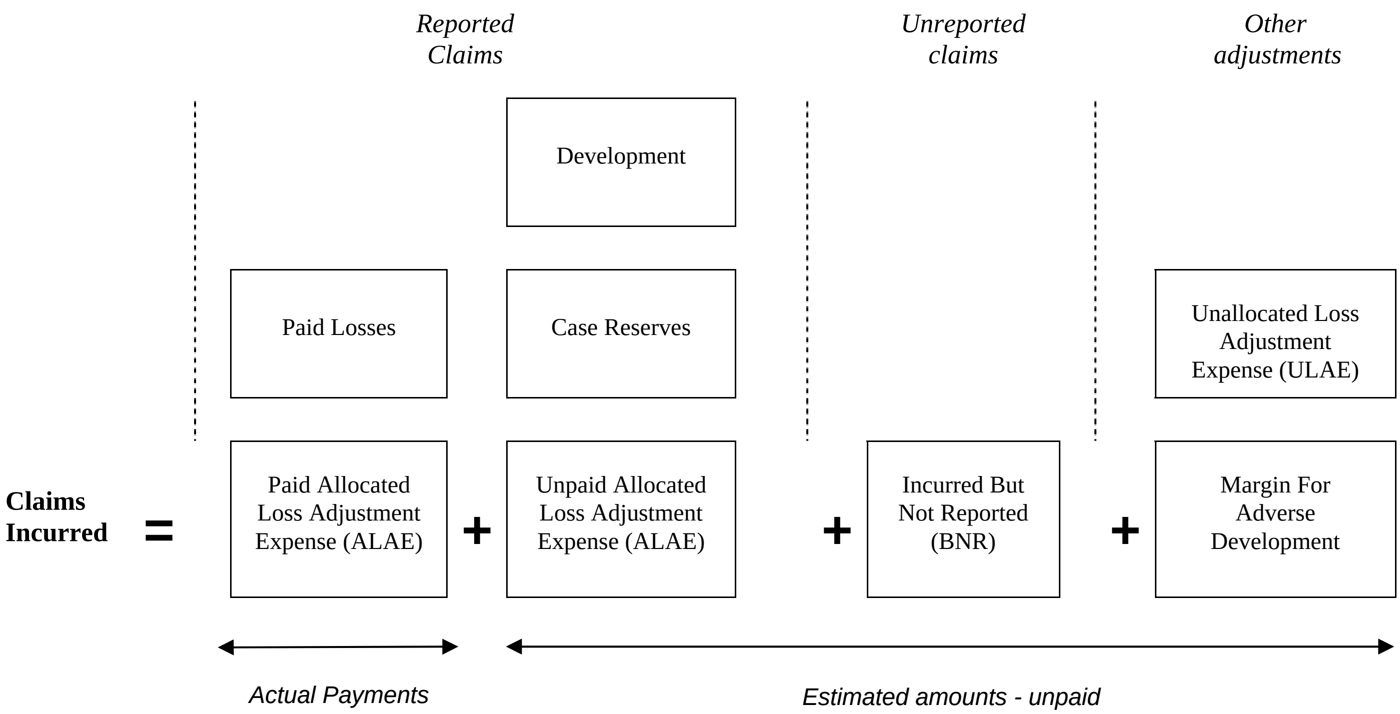
5.1.2 Claims and Related Costs

ICBC identifies three major categories of claims and related costs: claims incurred (including prior years' claims adjustment); claims services; and road safety and loss management services.

Claims Incurred (including prior years' Claims Adjustment)

Claims incurred (including prior years' claims adjustment) is the single most significant expense in ICBC's statement of operations. Figure 1 provides a more detailed breakdown of the components that make up claims incurred.

<u>Figure 1 Claims Incurred (Reference Application, Tab C. p. 18)</u>



Paid losses, paid and unpaid Allocated Loss Adjustment Expense ("ALAE"), Case Reserves and Development are largely allocated on a directly attributed basis on a claim-by-claim basis between Basic and Optional Insurance by examining the product type and the respective policy limits.

The Incurred But Not Reported ("IBNR") category was allocated between Basic and Optional Insurance, based on the distribution of earned premium between Basic third-party liability premium and Optional third-party liability premium. Unallocated Loss Adjustment Expense ("ULAE") was allocated based on the relative amount of unpaid amounts for Basic and Optional Insurance, since the size of unpaid amounts is believed to be a good indicator of the amount of work effort required to settle a claim.

Margin for Adverse Development provides for the potential of adverse developments such as natural catastrophes, uncharacteristic changes in weather patterns, or a landmark court case. ICBC's margin for adverse development is 5 percent of all unpaid amounts. Where these unpaid amounts are directly attributed, the margin was also considered directly attributed (Application, Appendix C, p. 20).

Claims Services

Claims Services expense are the internal costs of the activities at the claims handing facilities and the call centres including:

- reporting of claim and customer service functions;
- interview and assessment of liability;
- vehicle damage assessment, repair and salvage;
- rehabilitation and recovery;
- legal services;
- mediation; and
- negotiation and settlement.

For the purposes of cost allocation, Claims Services expense was segregated into four key categories: regional operations, specialized operations, call centre, and support services.

To allocate the costs of the regional operations, ICBC relied on the experience of a representative group of claims managers to determine estimates of work effort related to Basic and Optional Insurance activities. The general approach of the analysis was to estimate work effort by job categories and by coverage. The resulting allocation was approximately 61 percent to Basic Insurance and 39 percent to Optional Insurance.

Approximately 13 percent of Specialized Operations costs were directly attributable to specific functions in Basic or Optional Insurance. The remaining costs were allocated on the basis of a relative proportion of net claims incurred between Basic and Optional Insurance. ICBC notes that this allocation method was determined to be a reliable proxy for level of work effort and has been used by the Manitoba Public Insurance Corporation for many years (Application, Tab C, p. 23).

ICBC does not have a good measure for determining the time spent by call centre personnel on Basic versus Optional Insurance claims. ICBC believes that there is a close relationship between the allocation of claims costs and the activities of the call centre operations, so call centre operations were allocated on the basis of a proportional percentage of net claims costs.

Claims support costs were allocated based on work effort or best available proxies for work effort, such as the volume of specific transactions processed, charge backs, or net claims costs.

5.1.3 Road Safety and Loss Management Services

All road safety costs were directly attributed to Basic Insurance. Fraud prevention costs were allocated on the same basis as overall claims allocations, resulting in 61 percent allocated to Basic Insurance and 39 percent allocated to Optional Insurance.

5.1.4 Insurance Expenses

Insurance expenses were broken down into the following categories: Administrative and Other; Autoplan Services-Expenses; Autoplan 12 Recoveries; Commissions; and Premium Taxes. Administrative and other expenses represent the majority of insurance expenses that are allocated. Corporate support to the operational areas of claims services, loss management and road safety, and insurance were allocated on the same basis as the underlying costs of each of the business lines.

The allocation of Autoplan Services-Expenses was primarily based on work effort and to a lesser extent on premiums written. The Autoplan 12 recoveries were allocated to Basic and Optional Insurance based on premiums earned.

The commissions that ICBC pays brokers include a flat fee for the Basic Insurance business and a competitive level of commission for the Optional Insurance business, which is significantly higher than the flat fee. The flat fee is further allocated between Basic Insurance and non-insurance costs.

The insurance Premium Tax is applied to both the Basic and Optional Insurance premiums.

5.1.5 Non-Insurance Expenses

The costs of non-insurance services result from the Service Agreement between the Ministry of Public Safety and Solicitor General and ICBC effective September 1, 2003. All costs are allocated to Basic Insurance.

5.1.6 Investment Income and balance sheet split of liabilities and equity

ICBC chose to allocate Investment Income between Basic Insurance and Optional Insurance based on the balance sheet split of liabilities and equity for each line of business. The Corporation believes this sharing is appropriate on the basis that the investment risk tolerances and liability duration are similar for both lines of business.

To achieve the balance sheet split of liabilities and equity, ICBC adopted the following procedures:

- Unpaid Claims and Unearned Premiums (i.e. liabilities) are split between Basic Insurance and Optional Insurance in the same manner as claims incurred expense and premium revenues, which is described in previous sections.

- ICBC has temporarily used the Minimum Capital Test requirements defined by the federal Office of the Superintendent of Financial Institution's as the basis for allocating past retained earnings (i.e. equity). The Applicant is currently in discussion with the provincial government where options for capital allocation are being evaluated (Application, Tab C, p. 34).

5.2 Intervenor Views

Several of the Intervenors provided submissions or recommendations with respect to the allocation of costs and revenues undertaken by ICBC in Appendix C of the Application.

5.2.1 British Columbia Old Age Pensioners' Organization et al ("BCOAPO")

The final argument of the BCOAPO concluded with a series of ten recommendations to the Commission on the content of ICBC's Application to be filed next year. Item No. 4 of the recommendations states "ICBC should provide more comprehensive detail associated with the allocation methodology between competitive and basic insurance, since ICBC uses the same employees and IT systems for these two segments of its business."

5.2.2 The Insurance Bureau of Canada ("IBC")

The evidence and the final argument of IBC expresses the frustration that IBC believes it has had in obtaining information from ICBC. IBC believes it is not possible to ascertain the appropriateness of the requested rate increase or to provide cogent written evidence with respect to the rate increase because ICBC has refused to release the trend analyses requested by IBC.

The evidence of IBC focuses almost entirely on the financial allocation process in an effort to ensure that there is no cross subsidization between Basic and Optional Insurance products. Based on its review of the detailed financial allocations study, IBC has identified $49 million in costs and revenue that it believes would be more appropriately allocated to the Optional Insurance business.

With respect to the allocation of Prior Years' Claims adjustment, IBC believes that it would be more appropriate to allocate these costs based on claims incurred. This allocation would result in approximately $14 million of decreased allocation to Optional Insurance.

IBC notes that the allocation study uses a measure of work effort (work estimates for job categories by a sample of claims managers) as the allocation method of Claims Services. IBC believes that a work-effort methodology gives greater weight to the work that a claims manager may spend on a relatively more complicated liability claim compared with a less intensive comprehensive or collision claim. Since the volume of comprehensive and collision claims is significantly greater than for liability claims, the manager would likely spend more time on such claims than would be accounted for in a work-effort methodology. IBC believes that a claims incurred allocation method for Claims Services better represents the intensity and level of Claims Service distributed between the Basic and Optional Insurance coverages for all four categories (Regional Operations, Specialized Operations, Call Centre, and Support Services). The effect of this allocation would be to increase the allocation to Optional Insurance by approximately $9 million.

IBC accepts that the cost of providing a road safety program at ICBC should be allocated to Basic Insurance. However, IBC argues that where these initiatives are being used for branding purposes and the ICBC brand and logo, other than that of the government, is attached to the initiative, the cost should be allocated to the Optional Insurance coverage. "IBC believes that all traffic and enforcement initiatives carried out in association with the ICBC brand are more appropriately allocated to the optional coverage. Traffic and enforcement initiatives carried out under the provincial brand should be allocated to the basic coverage" (IBC Evidence, p. 5).

IBC argues that Administrative and Other Expenses should be allocated based on earned premiums. IBC believes that there is little rationale in support of a higher allocation of work effort associated with corporate governance, finance and information services to the Basic Insurance coverage compared to the Optional Insurance coverages.

IBC notes that Autoplan Services expenses include costs related to product development, underwriting, promotion and administration of ICBC's insurance products. IBC believes that there is limited need for promotion of the Basic Insurance product and because the Government through legislation and regulation has defined the Basic Insurance product, there are no product development costs associated with Basic Insurance.

After making adjustments to these two expense areas, IBC would allocate an additional $28 million to the Optional Insurance cost.

IBC also disputes the allocation of Investment Income. It believes that a more appropriate methodology would be to use claims incurred to split investment income between Basic and Optional Insurance. This would result in $27 million of increased allocation to Optional Insurance coverage (IBC Evidence, Table 4, p. 7).

Comparing the December 31, 2002 Statement of Operations for ICBC allocated between Basic and Optional Insurance services as shown in the Application, Appendix C, page 12 to the adjusted allocation undertaken by IBC, results in the allocated net income for Basic Insurance coverage increasing from $43.572 million in the ICBC allocation to $92.539 million as a result of the IBC adjustments. The Optional Insurance coverage net income would drop from $1.396 million in the ICBC allocation to a loss of $47.571 million in the IBC allocation.

5.2.3 HSBC Canadian Direct ("HSBC")

HSBC submits that the pro-rata method of allocation loads more costs on to Basic Insurance than it would necessarily incur to discharge its responsibilities adequately and efficiently. It believes that the pro-rata method results in subsidization of the Optional Insurance. The Commission is encouraged to require ICBC to recover the full value of services provided to the Optional Insurance, which would have the effect of reducing costs in the Basic Insurance (HSBC Evidence, p. 5).

HSBC also believes that retained earnings and investment income should be allocated based on how those funds have been earned. HSBC believes that the Corporation has the means to calculate the relative contributions to retained earnings of the Basic and Optional Insurance. It identifies three reasons why it believes that a reconciliation of these accounts would favour the Basic Insurance:

> "The Eckler report and exhibits show very positive trends in Bodily Injury frequency and severity which clearly were not fully anticipated. These would have resulted in significant prior year adjustments for Bodily injury, as were seen up to and including 2001. Mr. Weiland, at the Workshop which launched this regulatory review, indicated that prior year reserve adequacy is closely and regularly monitored, by each coverage, and presumably a record of prior year changes, by coverage, is available.
>
> Based on the existing allocation, Basic earns in excess of 2/3 of the Corporation's investment income and is presumably entitled to claim its impact on retained earnings.
>
> Basic appears to have been more rate adequate, relative to Optional, at the end of the six year rate freeze (2001 policy year), as revenue requirements for Optional have exceeded those of Basic, despite significant increases to minimum deductible levels offered by Optional" (HSBC Evidence, p. 7).

5.2.4 Pemberton Insurance Corporation ("Pemberton")

Pemberton also takes issue with ICBC's choice of a pro-rata allocation methodology for shared costs and revenues. It believes that a significant burden of the cost of claims lies with the first-party insurer (the Optional Insurance coverage) and the additional or incremental cost to evaluate these claims reports should be relatively minimal to the Basic Insurance coverage division. The effect of this incremental method of allocation would be similar to that posed to ICBC in Commission Staff Information Request 1A.9.1.3. ICBC responded to that Information Request to state: "Allocating costs first to the optional business with the incremental costs allocated to basic would result in non-regulated customers bearing much of the cost of the regulated business. This is not putting ICBC's optional insurance on an equal basis to private insurers."

With respect to the various licensing matters generically referred to as the non-insurance operations, Pemberton believes that they should not be allocated to the Basic Insurance coverage, but should come from ICBC as an entity, rather than from a division of ICBC. The Applicant responded to this suggestion in its Reply Argument stating that the provisions of clauses 2(2)(a)(ii) and (iii) of the Special Direction direct that non-insurance costs be covered by Basic Insurance.

Pemberton also argues that ICBC is the beneficiary of benefits from the provincial government including the "ultimate guarantee," absence of income taxation and cost of capital. The "ultimate guarantee" relates to the benefit that customers would anticipate in the event of ICBC becoming insolvent and the claims being honoured by the Province. Pemberton values this benefit at 3 percent of premiums. Pemberton believes that the notional value of income taxation should be included as a cost for Optional Insurance coverage. Finally, it also believes that a notional cost of capital should include a deemed return on equity at a rate of 17 percent.

In its recommendations, Pemberton asserts that the Basic Insurance coverage premiums must return to a non-profit basis and that the Optional Insurance coverage premiums be adjusted to level the playing field with private insurers. Since Basic Insurance coverages are provided by a sole government provider, Pemberton believes it should be considered a public good and run on a non-profit basis. The effect of the proposed changes by Pemberton would lead to a reduction in Basic Insurance revenue requirement of 10 percent and increase Optional Insurance by approximately 14 percent.

5.3 Commission Panel Determinations

The Commission Panel recognizes and appreciates the considerable effort undertaken by ICBC to bring together a financial allocation methodology for this Application. That methodology, dated August 25, 2003, is a substantial effort by ICBC to address the difficult issues of allocating shared costs and revenues between the two lines of business. The Commission also appreciates the efforts of the Intervenors to test the appropriateness of the individual allocations. While the Commission believes that this allocation study has gone a considerable distance to fairly allocate revenues and costs between the Basic and Optional Insurance lines of business, the Commission will require further analyses and testing of the individual allocations in next year's proceeding before finalizing the methodology for future years.

One area of considerable controversy was with respect to the guiding principle of allocation. ICBC argues that the pro-rata approach is most appropriate. Some Intervenors have suggested that either the full value of services provided to Optional Insurance coverage should be recovered by the Basic Insurance or that the Basic insurance should only be charged those costs incremental to the provision of Optional Insurance. **For the purposes of this Application, the Commission Panel accepts that the pro-rata approach undertaken by ICBC provides a**

reasonable segregation of costs and income between the Basic and Optional Insurance. However, the Commission expects ICBC to fully address the alternative allocation methodologies in its next application.

The Commission Panel is aware of problems with allocating costs. For example, in the instance where an accident occurred and third party liability was well in excess of the $200,000 limit under the Basic Insurance policy, ICBC could easily find itself in a court proceeding that fundamentally was deciding whether the award or settlement should be, say, $300,000 at the lower end or $400,000 at the higher end. ICBC and third parties would presumably go to considerable time and effort (medical reports, legal proceedings, etc.) to prove the case of the higher or lower end of the range. If the award or settlement is achieved at a figure exceeding $200,000, it may not be relevant to the Basic Insurance business as its limits would have already been exceeded. It may be reasonable, therefore, that the costs of the loss adjustment expense should not be borne by the Basic Insurance business, but be attributed to only the Optional Insurance business. The pro-rata methodology may not achieve the proper result.

IBC undertook considerable work to identify alternative allocations with respect to a number of individual cost and revenue areas. These include prior years' claims, claims services, the cost of promoting road safety, allocation of administrative and other expenses, promotions of Autoplan services and the allocation of investment income and retained earnings. **These alternative allocations have sufficient merit that the Commission Panel directs ICBC to provide detailed analyses of the merits of the alternative allocation methodologies in its next regulatory proceeding.**

Pemberton identified three areas where notional costs could be attributed to the Optional Insurance coverage division. These relate to the provision of a guarantee by the province of British Columbia, a notional accounting of income tax and a return on equity to put the Optional Insurance division on a similar basis to private insurers. In addition, Pemberton believes that the Basic Insurance coverage is a public good which should be run on a non-profit basis.

The Commission Panel recognizes that the Pemberton proposal would result in a fundamentally different cost allocation process for ICBC compared to that which has been undertaken by ICBC and as identified in the Special Direction. **At this juncture, the Commission Panel does not believe it is in a position to order the changes proposed by Pemberton although the Special Direction expected for next year may provide further information on the appropriateness of charging the Optional Insurance coverage for the natural benefits it receives from being a Crown Corporation.**

In considering the issues with respect to promotion costs in support of road safety and other government programs, the Commission Panel concludes that these costs are appropriately charged to those programs. However, the Intervenors have identified that ICBC's Optional Insurance line of business is benefited by the media exposure of those promotions. It appears that the Optional Insurance program benefits from this promotion of the brand and the Commission Panel encourages ICBC to change its practices with respect to brand advertising in connection with a government program or determine the value of this advertising which would then be charged to the Optional Insurance product.

The Commission Panel accepts ICBC's allocation of past retained earnings based on outstanding liabilities and directs ICBC to segregate retained earnings by Basic and Optional Insurance business, commencing in 2004. Future allocations may be clarified by a Special Direction from Government.

6 INFORMATION REQUIREMENTS

The Commission has received a number of complaints from Intervenors regarding the lack of complete response by ICBC to their questions. It should be noted that the Commission also regards its information requests as not having been fully answered. However, it is the Commission Panel's view that the required schedule for a decision and the general lack of availability of some information does not allow for more in-depth questioning of ICBC at this time.

Other regulated companies have the benefit of a long history of regulatory review. Appropriate detailed data is diligently gathered on an annual basis and cost review measures are well thought through and accepted. ICBC, through no fault of its own, does not enjoy a similar history. Its cost data and first Application may be viewed with some concern or suspicion and may be subject to potential misunderstanding until such time as a complete baseline of costs have been established and appropriate cost measures are agreed for the Basic Insurance business.

In these circumstances, the Commission Panel urges ICBC to "go the extra mile" on disclosure in the early stages in order to leave no room for doubt regarding its costs and procedures for the Basic Insurance business. ICBC cannot change how it has been organized historically. It can, however, ensure that data collection going forward will provide the maximum assurance to the Commission, ICBC's customers and other interested parties that its operations are "adequate, efficient, just and reasonable."

In order to properly execute its responsibilities and gain input from both Intervenors and ICBC, the Commission Panel believes an appropriate first step is to determine through oral hearing, the appropriate database of information that will be required from ICBC in future. This will allow the Commission to properly regulate ICBC's Basic Insurance business, enhance competition in the Optional Insurance business and ensure no cross-subsidization of ICBC's Optional Insurance business from the Basic Insurance business. It will also allow ICBC sufficient time to adjust its systems and procedures to gather appropriate data. While complete trend data may not be immediately available, a better understanding of the basic cost structure will result.

Further, it is important to establish what information gathered from the Basic Insurance business should be shared with all participants in the Optional Insurance business in order to enhance competition. ICBC gathers significant information on the Basic Insurance business and presumably uses that information in its Optional

Insurance business.

Subject to contrary argument at the appropriate time, the Commission Panel has been offered little evidence as to why this information should be held solely for the benefit of ICBC's Optional Insurance business and not shared fully with other market participants. In fact, ICBC argues "…if this data is not protected a competitor could leverage the information without paying the price of admission" (ICBC Final Argument, p. 10) The Commission Panel views this comment as possibly demonstrating that ICBC's Optional Insurance business gains from the Basic Insurance business data.

While the Commission Panel agrees this data should not be revealed on a customer specific basis, it has not been provided sufficient information to demonstrate why this information should not be shared in some aggregate fashion for the benefit of all Optional Insurance competitors, thereby putting them all on a level playing field. It concerns the Commission Panel that ICBC could take advantage of this information to the exclusion of the rest of the market. The Commission is prepared during the next proceeding to hear argument as to what Basic Insurance data should be shared and in what manner, following a proposal by ICBC.

The Commission Panel would like to paraphrase the section entitled "Going Forward" in the final argument of the BCOAPO. As part of the next proceeding the Commission expects to see:

1. Detailed evidence that will support the Basic Insurance Business Statement of Operations and outline assumptions used for premium forecasts, operating expenses and all reserves.

2. Provision of all available historical comparisons of forecast and actual results for the Basic Insurance business Statement of Operations.

3. A three to five year forecast of the Basic Insurance Business Statement of Operations to ensure rates are set that will avoid future "rate shocks."

4. Comprehensive detail concerning the allocation methodology used between the Basic and Optional Insurance business.

5. The Commission would appreciate ICBC's views on the appropriate level for retained earnings for the Basic Insurance Business which will provide adequate future rate stabilization.

6. Provision of ICBC bench-marking against industry standards and how to tie these standards to management and staff compensation.

The Commission Panel does not ask for a study of the costs and benefits of a no-fault insurance environment in British Columbia as requested by BCOAPO. It does, however, assume ICBC will always bring forward for the

Government's consideration any approach it believes will enhance value to its customers after due consideration of the benefits and weaknesses of such approaches.

Finally, the Commission expects ICBC to develop a proposal by the beginning of 2004 regarding how to fairly distribute claims information to all competitors in the market gained from the Basic Insurance business in a way that will not violate individual customer confidentiality. This proposal will form part of the oral public hearing to begin early in the new year.

7 COMMISSION DETERMINATION

7.1 Decision

The Application was submitted pursuant to section 44 of the *Insurance Corporation Act*, sections 58 and 61(2) of the *Utilities Commission Act* and Special Direction IC1. Details of this Legislation have been provided in Chapter 1.

The Commission Panel is generally satisfied that the evidence in this first ever review of ICBC's Application for Basic Insurance has provided valuable insights into the Corporation and adequate analysis to allow the Commission to establish rates for 2004. The Commission Panel recognizes that the time constraints for this year's review have been challenging for all participants, including the Commission. ICBC was hard pressed to provide its Application by August 29, 2003 since the Special Direction was not issued until August 12, 2003. Much of the information in support of the Application was only completed days before the filing was made. In particular, the financial allocation methodology, which underpins the cost allocation between Basic and Optional Insurance activities is dated August 25, 2003.

Equally though, the timetable for the written public hearing established by Commission Order No.G-54-03 was constrained to the point of having little available time to deal with late filings or disputes with respect to information requests and responses. Intervenors were frustrated with the short timetable and their perception of inadequate information provided by ICBC. It has become obvious that a major issue for next year's proceedings will be determinations by the Commission on what kinds of information are required to be filed by ICBC and what information may be held confidential for commercial interests.

Nonetheless, the Commission Panel has received sufficient information to assess the revenue requirements request for 2004. In addition, this year's limited proceeding has provided valuable information to all parties as a precursor to the more substantial review that is required for ICBC's next revenue requirements application.

Based on the evidence and the Commission Panel conclusions in this Decision, the Commission Panel rejects the requested amendment to Basic Insurance rate schedules to increase rates by 1.3 percent. Approval is granted, however, to amend the Basic Insurance premium rate schedules to increase rates by 0.4 percent to flow-through the increase in premium tax, effective January 1, 2004.

In Section 2.3 of this Decision, the Commission Panel has considered the issue of the proposed 0.9 percent increase to provide funds for the potential increase in the Court Tariff in mid 2004. The Commission Panel determined that the degree of uncertainty surrounding this issue does not warrant an increase in Basic Insurance rates for 2004, but has offered a transitional approach.

7.2 Program for Next Year

This Application to amend Basic Insurance premium rate schedules was a new experience for most participants. This proceeding was affected by a general lack of familiarity with the BCUC's regulatory process, a lack of familiarity by some with ICBC or the insurance industry, and further by the expedited process required to render a decision by mid November. As parties become more familiar with the regulatory process, and as ICBC transitions to a regulated environment, it is expected that the Corporation will be better able to support future revenue requirements applications and address information requests on issues relevant to the Basic Insurance business.

Pemberton suggests on page 15 of its Submission that "…[the]BC Utilities Commission take the first year of regulatory review as an opportunity to take position, and to support and advocate the prudent course of action" and at page 18 of ICBC's Final Reply, it states: "ICBC has provided, and in future will provide, information relevant to the review of basic rates. As ICBC becomes more familiar with the requirements of a regulatory review by the Commission, the Corporation will further endeavour to address the legitimate expectations of Intervenors and to assist the Commission in fulfilling its mandate of setting just and reasonable rates."

Chapter 6 of this Decision addresses some of the information needs for future proceedings. In fulfilling the Commission's mandate with respect to ICBC, the Commission has a number of objectives related to process. They include:

- establishing an efficient and effective process for Revenue Requirement Requests that meets the needs of ICBC, Intervenors and the Commission;
- establishing an agreed information base and operating procedures (by ICBC) which will demonstrate the appropriate separation of Basic and Optional Insurance business;
- establishing appropriate operating metrics by ICBC related to the Basic Insurance business which will be useful to ICBC, the Commission, Intervenors and Interested Parties in monitoring and measuring the Corporation's performance in providing Basic Insurance in a manner considered in all respects adequate, efficient, just and reasonable; and

- ensuring that there is no cross-subsidization of Optional Insurance by the Basic Insurance business line and that ICBC does not abuse its position as the dominant supplier of automobile insurance in British Columbia.

To achieve these objectives, the Commission is proposing two regulatory proceedings for 2004. The first proceeding, to occur early in 2004 will include an oral public hearing to review the information disclosure requirements of the Corporation. Finalization of the allocation methodology for assigning costs and revenues between Basic and Optional Insurance is another deliverable. In addition, this proceeding will establish the metrics and reports by which all parties will monitor the Corporation's performance in providing Basic Insurance and will also form the basis on which the Commission will review future revenue requirement requests. A future Order of the Commission will detail the timing and content of the oral public hearing.

The second regulatory proceeding will consider ICBC's Revenue Requirement for 2005. The timing of this review will be dependant on the ICBC business planning cycle; however, it is anticipated it would follow roughly the same schedule as this hearing. The 2005 Revenue Requirement review will be simplified in that many of the issues that proved challenging to participants this year will have been resolved by the Commission's decisions following the first proceeding. ICBC will also benefit from a clearer understanding of the nature and scope of information expected to support the Revenue Requirement for 2005 and will have had an opportunity to establish internal reporting systems to provide this information.

Dated at the City of Vancouver, in the Province of British Columbia, this 12th day of November 2003.

Original signed by:

Len Kelsey
Commissioner and Panel Chair

Original signed by :

Murray Birch
Commissioner

Original signed by :

Peter Vivian
Commissioner

BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-75-03

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IN THE MATTER OF
the Insurance Corporation Amendment Act, 2003, SBC 2003, Chapter 35
and
the Insurance Corporation Act, RSBC 1996, Chapter 228
and
the Utilities Commission Act, RSBC 1996, Chapter 473
and
Special Direction IC1 to the British Columbia Utilities Commission
and
An Application by the Insurance Corporation of British Columbia
for Approval of 2004 Revenue Requirements and rates for Universal Compulsory Automobile Insurance

BEFORE:	Len Kelsey, Commissioner	)	
	and Panel Chair	)	November 12, 2003
	Murray Birch, Commissioner	)	
	Peter Vivian, Commissioner	)	

O R D E R

WHEREAS:

A. On August 29, 2003, the Insurance Corporation of British Columbia ("ICBC") filed for approval of its 2004 Revenue Requirements Application ("Application") and to increase premiums for Universal Compulsory Automobile Insurance ("Basic Insurance") by 1.3 percent applicable to all contracts taking effect on or after January 1, 2004, pursuant to Section 44 of the Insurance Corporation Act, and Sections 58 and 61(2) of the Utilities Commission Act; and

B. The Application proposed to increase premiums for Basic Insurance as a result of increases in ICBC's 2004 forecast cost of service for Basic Insurance; and

C. The Commission, by Order No. G-54-03 dated September 2, 2003, established a Regulatory Agenda and Timetable for a written hearing and a public workshop regarding the Application.

D. The Commission held a public workshop on September 11, 2003 in Vancouver, B.C.; and

E. The Commission issued Letter No. L-48-03 dated October 2, 2003 and granted ICBC's request that it not be required to respond to the information request of Mr. Russell Sykes; and

F. The Commission issued Letter No. L-50-03 dated October 16, 2003 and denied a request for a decision in the October 3, 2003 submission of the Office & Professional Employees' International Union, Local 378; and

G. Written Final Arguments and Reply Argument were completed on October 24, 2003; and

H. The Commission Panel has considered the Application and the written evidence.

NOW THEREFORE the Commission orders as follows:

1. The requested amendment to Basic Insurance premium rate schedules to increase rates by 1.3 percent for contracts effective on and after January 1, 2004 is not approved.
2. The amendment to Basic Insurance premium rate schedules to increase rates, for contracts effective on and after January 1, 2004, by 0.4 percent to flow-through the increase in premium tax, effective January 1, 2004 is granted.
3. ICBC is directed to comply with all determinations and instructions set out in the Decision that is issued concurrently with this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 12th day of November 2003.

BY ORDER

Original signed by:

Len Kelsey
Commissioner and Panel Chair

Attachment

APPENDIX A

SPECIAL DIRECTION IC1 TO THE BRITISH COLUMBIA UTILITIES COMMISSION

Application

1 This special direction is issued by the Lieutenant Governor in Council to the British Columbia Utilities Commission (the "commission") under the authority of section 47 of the *Insurance Corporation Act* (the "Act") with respect to the exercise of the commission's powers and functions as they apply to the corporation.

Direction relating to the corporation

2 (1) The following financial outcome targets are established for the corporation:

(a) the net income target for the corporation generally for 2004 is $36 million;

(b) the net income target for the corporation's optional automobile insurance business for 2004 is $0.

(2) With respect to the exercise of its powers and functions under the Act in relation to the corporation, the commission must

(a) fix rates for universal compulsory automobile insurance that the commission believes are consistent with the corporation achieving the net income targets established for 2004 under subsection (1), after taking into account

(i) the costs that are to be incurred by the corporation in that year for road safety programs under section 7 (i) of the Act, including, without limitation, payments by the corporation to any level of government with respect to road safety,

(ii) the costs that are to be incurred by the corporation in that year for vehicle licensing, driver licensing and other services and activities of the corporation under section 7 (g) and (h) of the Act that are to be undertaken in that year in accordance with the agreement, as amended from time to time, entitled "Service Agreement between The Ministry of Public Safety and Solicitor General and the Insurance Corporation of British Columbia" and dated as of September 1, 2003,

(iii) the payments that the corporation is to make in that year under the agreement entitled “Memorandum of Understanding between B.C. Provincial Government and ICBC” and executed in February, 2003, and

(iv) the commissions that the corporation is to pay in that year to persons appointed as agents by the corporation under section 16 of the *Insurance (Motor Vehicle) Act* for collecting government fees and other revenue on behalf of the corporation, and

(b) subject to subsection (4) of this section, ensure that universal compulsory automobile insurance rates are not based on age, gender or marital status.

(3) With respect to the exercise of its powers and functions under the Act in relation to the corporation, the commission must not fix rates applicable to optional automobile insurance.

(4) The commission may approve universal compulsory automobile insurance rates that provide discounts to or are otherwise preferential for

(a) persons who are at least 65 years of age, or

(b) persons with disabilities.

(5) In regulating and fixing rates for the corporation, the commission must treat any premiums levied under sections 34 (1.1) (e) of the *Insurance (Motor Vehcile) Act* as revenue for the corporation’s universal compulsory automobile insurance business.

APPENDIX B – LIST OF INTERVENORS AND INTERESTED PARTIES

The Insurance Brokers of British Columbia

BC Public Interest Advocacy Centre

Coalition Against No-Fault in BC

Al Mansukh

Mark Metzner

McCarthy & Associates

Pemberton Insurance Corporation

HSBC Canadian Direct Insurance Inc.

BCAA Traffic Safety Foundation

B.C. Chiropractic Association

Russell Sykes

Family Insurance Solutions Inc.

Office & Professional Employees' International Union Local 378

Insurance Bureau of Canada

Trial Lawyers Association of British Columbia

Lyle Allen Carter

Mark Lodders

BC Taxi Association

Thompson's Insurance News

APPENDIX C – SUBMISSIONS

Insurance Corporation of British Columbia Application, August 29, 2003.

Insurance Corporation of British Columbia Universal Compulsory Automobile Insurance 2003 Rate Schedule to be included as part of Insurance Corporation of British Columbia's Application for 2004 Revenue Requirements, dated August 29, 2003

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1. Copy of Insurance Corporation of British Columbia Public Workshop Slide Presentation from the Workshop

2. Information Request from Family Insurance Solutions Inc., dated September 17, 2003

3. Information Request from Pemberton Insurance Corporation, dated September 18, 2003

4. Information Request from Mark Metzner, dated September 19, 2003

5. Submission regarding registering of observations from McCarthy & Associates, dated September 19, 2003

6. Questions and Information Requests from Office & Professional Employees' International Union Local 378, dated September 19, 2003

7. Information Request from HSBC Canadian Direct Insurance Inc., dated September 19, 2003

8. Information Request from B.C. Chiropractic Association, dated September 19, 2003

9. Information Request from Coalition Against No-Fault in BC, dated September 19, 2003

10. Information Request from B.C. Old Age Pensioners' Organization *et al.*, dated September 19, 2003

11. Information Request from Insurance Bureau of Canada, dated September 22, 2003

12. Information Request from Al Mansukh, dated September 19, 2003

13. Insurance Corporation of British Columbia's responses to British Columbia Utilities Commission Information Request No. 1, dated September 26, 2003

14. Written submission from BCAA Traffic Safety Foundation, advising of significant contributions Insurance Corporation of British Columbia is making in improving road safety, dated September 29, 2003

15. Additional responses to British Columbia Utilities Commission Information Request No. 1 from Insurance Corporation of British Columbia, dated October 1, 2003

16. Request for Information and Clarification by Coalition Against No-Fault in BC, dated October 3, 2003

17. Submission of written evidence for October 3, 2003 from B.C. Chiropractic Association, dated October 2, 2003

18. Submission of written evidence from Family Insurance Solutions Inc., dated October 3, 2003

19. Submission of evidence from Insurance Bureau of Canada, dated October 3, 2003

20. Submission of HSBC Canadian Direct Insurance Inc., dated October 3, 2003

21. Submission by Office & Professional Employees' International Union Local 378, dated October 3, 2003

22. Further response and information from Insurance Corporation of British Columbia requested by Al Mansukh, dated October 3, 2003

23. Affidavit for Notice of Public Workshops and Written Public Hearing Process from Insurance Corporation of British Columbia, dated October 9, 2003

24. Supplemental Responses to British Columbia Utilities Commission Information Request No. 1 from Insurance Corporation of British Columbia, dated October 10, 2003

25. Insurance Corporation of British Columbia's response to Al Mansukh's request, dated October 10, 2003

26. Final Argument of Insurance Corporation of British Columbia for its 2004 Basic Insurance Rates Application, dated October 10, 2003

27. Final Argument of Family Insurance Solutions Inc. regarding Insurance Corporation of British Columbia's Application, dated October 16, 2003

28. Submission of Insurance Bureau of Canada's Expense Allocation spreadsheets and methodology, dated October 17, 2003

29. Final Argument of B.C. Old Age Pensioners' Organization *et al.* regarding Insurance Corporation of British Columbia's Application, dated October 17, 2003

30. Final Argument and Submission of Evidence of Office & Professional Employees' International Union Local 378, dated October 17, 2003

31. Insurance Bureau of Canada's response to Insurance Corporation of British Columbia's Final Submission for its 2004 Rates Application, dated October 17, 2003

32. Final Argument of HSBC Canadian Direct Insurance Inc., dated October 17, 2003

33. Submissions of Pemberton Insurance Corporation, dated October 17, 2003

34. Insurance Corporation of British Columbia's response to Family Insurance Solutions Inc.'s Information Request, dated October 21, 2003

35. Final Reply Argument of Insurance Corporation of British Columbia, dated October 24, 2003