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BRITISH COLUMBIA UTILITIES COMMISSION

ORDER NUMBER G-137-10

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IN THE MATTER OF

the Utilities Commission Act, R.S.B.C. 1996, Chapter 473, as amended
and
the Insurance Corporation Act, R.S.B.C. 1996, Chapter 228, as amended
and
A Streamlined Application by the Insurance Corporation of British Columbia for approval of the 2010 Revenue Requirements for Universal Compulsory Automobile Insurance and
An Application for Approval of a Plan Regarding Universal Compulsory Automobile Insurance Excess Capital Available

BEFORE: A.W.K. Anderson, Panel Chair/Commissioner August 31, 2010
L.F. Kelsey, Commissioner
L.A. O'Hara, Commissioner

O R D E R

WHEREAS:

A. The British Columbia Utilities Commission (the Commission) issued Order G-65-10 on April 6, 2010 approving the Amended Streamlined Process Application of the Insurance Corporation of British Columbia (ICBC), subject to directives contained in the Reasons for Decision, which set out the process to be followed for future revenue requirements applications relating to Universal Compulsory Automobile Insurance (Basic Insurance);

B. Pursuant to Order G-65-10 Reasons for Decision, ICBC was directed to file an application proposing a plan to deal with Basic Insurance Excess Capital Available (Basic Insurance excess capital) in excess of 150 percent of the minimum capital required as at December 31, 2009;

C. On April 29, 2010, the Lieutenant Governor in Council of British Columbia issued Orders in Council 222, 223,and 224 containing directives and orders affecting the regulation of ICBC by the Commission;

D. On May 27, 2010, the Government of British Columbia approved a May 18, 2010 letter of direction to ICBC with respect to the conditions under which Basic Insurance capital in excess of the management target for the Minimum Capital Test (MCT) can be released;

E. On May 31, 2010, ICBC submitted an application to the Commission for approval of the 2010 Revenue Requirements for Basic Insurance and approval of a plan regarding Basic Insurance excess capital available (the Application);

.../2

F. ICBC requested approval for a 1.9 percent decrease in Basic Insurance rates for all new or renewal policies with an effective date on and after November 1, 2010 (Policy Year), approval of ICBC's proposed plan to address Basic excess capital above 150 percent of minimum capital required, which reflects the Government letter of direction of May 18, 2010 and requested approval for changes to the cost allocator and name for the Marketing and Broker Services function;

G. ICBC held an informal presentation on June 7, 2010 and a Review Working Session on June 17, 2010 for Commission staff and Interveners;

H. ICBC filed Supplementary Information on June 25, 2010 in response to requests made at the Review Working Session;

I. Registered Interveners filed Letters of Comment on August 4, 2010 and ICBC filed its Reply Submission on August 17, 2010;

J. The Commission Panel has identified three areas of concern in the Application that will be addressed further in its Reasons for Decision:

1. intergeneration equity for policyholders due to the rapid growth in the Basic Insurance excess capital available;
2. forecasting total corporate operating costs;
3. the impact of the Capital Management Plan on the growth of the Basic Insurance excess capital available;

K. ICBC operating expenses in the period 2006 to 2009 were, on average, 2.8 percent lower than forecast, and ICBC has acknowledged that its 2010 operating expenses may be lower than forecast and states that a 2.8 percent reduction to operating expenses translates to a 0.5 percent decrease in the Basic Insurance rate indication;

L. ICBC has requested an Order with respect to this Application by August 31, 2010 to facilitate putting new rates into effect on a timely basis;

M. The Commission Panel has considered the Application, the evidence and the submissions and has determined that, with some modifications, the Application should be approved.

NOW THEREFORE pursuant to the applicable provisions of sections 59, 60 and 61 of the *Utilities Commission Act*, the Commission orders, with Reasons for Decision to follow, that:

1. The Application to decrease Basic Insurance rates by 1.9 percent for the 2010 Policy Year is modified to require a decrease of 2.4 percent, comprising the 1.9 percent applied-for rate reduction plus a further 0.5 percent rate reduction for Commission determined adjustments to operating costs.

2. ICBC is directed to include additional information in the 2011 policy year revenue requirements filing indicating, in simple terms, how the impacts of the Distracted Drivers Campaign, Road Safety Initiatives (including the improvements to the Sea-to-Sky highway and completion of the Canada Line transit link), and Claims Initiatives are treated in the actuarial trend analysis.

3. ICBC's plan to address Basic Insurance excess capital greater than 150 percent of minimum capital required as filed in the Application is accepted, including continuation of the capital maintenance provision and, pursuant to the Government letter of direction of May 18, 2010, retention of the Basic Insurance capital in excess of the management MCT target.

4. ICBC's proposed use of the Corporate Shared Services Ratio as the allocator for Marketing and Broker Services costs and proposed name change to Marketing Communication as set out in Appendix 7F of the Application are approved.

5. Basic Insurance policyholders are to be notified of the Basic Insurance rate decrease in the most cost-effective manner. The notice is to be approved by the Commission in advance of its release.

6. The Commission will accept, subject to timely filing, amended Basic Insurance rate schedules in accordance with the terms of this Order.

DATED at the City of Vancouver, in the Province of British Columbia, this 31st day of August 2010.

BY ORDER

Original signed by:

A.W.K. Anderson
Panel Chair/Commissioner

IN THE MATTER OF

**A STREAMLINED APPLICATION BY
THE INSURANCE CORPORATION OF BRITISH COLUMBIA
FOR APPROVAL OF THE 2010 REVENUE REQUIREMENTS
FOR UNIVERSAL COMPULSORY AUTOMOBILE INSURANCE**

REASONS FOR DECISION
to Order G-137-10

November 24, 2010

BEFORE:

A.W.K. Anderson, Panel Chair/Commissioner
L.F. Kelsey, Commissioner
L.A. O'Hara, Commissioner

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LIST OF ACRONYMS

Basic Insurance	universal compulsory automobile insurance rates
BCOAPO	British Columbia Old Age Pensioners' Organization *et al.*
BU	Bargaining Unit
DRP	Driver Risk Premium
FTEs	full time employees
IBC	Insurance Bureau of Canada
ICBC	Insurance Corporation of British Columbia
ISC	Intersection Safety Cameras
M&C	Management and Confidential
Minimum Capital Test	MCT
OIC	Order in Council
OSFI	Office of the Superintendent of Financial Institutions
PY, PY 2010	Policy Year, Policy Year 2010
RRA	Streamlined Revenue Requirements Application
Special Direction IC2	Special Direction IC2 to the BC Utilities Commission, BC Regulation 307/2004, as amended
the Application	May 31, 2010 Application for a decrease in universal compulsory automobile insurance rates and a plan to address Basic Insurance capital in excess of 150 percent of the Minimum Capital Test
the Commission, or BCUC	British Columbia Utilities Commission
the ICA	*Insurance Corporation Act*
the UCA or the Act	*Utilities Commission Act*
TP	Transformation Program

1.0 EXECUTIVE SUMMARY

On May 31, 2010, the Insurance Corporation of British Columbia (ICBC) filed an application to the British Columbia Utilities Commission (the Commission, or BCUC), under the Streamlined Revenue Requirements process as established in Commission Decision G-65-10, requesting approval for:

- a decrease in universal compulsory automobile insurance rates (Basic Insurance) rates of 1.9 percent for all new or renewal policies with an effective date on and after November 1, 2010 (Policy Year 2010 or PY 2010);
- a plan to address Basic Insurance capital in excess of 150 percent of the Minimum Capital Test (MCT) in response to the Commission directive in Order G-65-10; and
- changes to the Marketing and Broker Services Allocation.

(the Application)

The Commission Panel ordered a decrease in Basic Insurance rates of 2.4 percent, an increase of 0.5 percent more than the 1.9 percent requested in the Application. The Panel accepted ICBC's plan addressing excess Basic Insurance capital and approved the Marketing and Broker Services Allocation requests.

<u>Decrease in Basic Insurance Rates of 1.9 Percent</u>

Basic Insurance rates are based on the actuarial rate indication prepared in accordance with accepted actuarial practice pursuant to *Special Direction IC2*. The requested rate decrease of 1.9 percent is reflective of the PY 2010 actuarial rate indication analysis prepared by ICBC.

The Commission Panel identified three areas of concern in relation to the PY 2010 actuarial rate indication analysis:

- intergeneration equity for policyholders due to the rapid growth in the Basic Insurance excess capital available;
- forecasting total corporate operating costs; and
- the impact of the Capital Management Plan on the growth in Basic Insurance excess capital available.

The Commission Panel determined that ICBC has provided adequate evidence to support the PY 2010 actuarial rate indication analysis except in relation to Operating Expenses; however, the Panel identified specific concern with ICBC's efforts in obtaining related experience data. As a result, the Commission Panel directed ICBC to include additional information in regards to certain prospective adjustments into the 2011 Revenue Requirements Application in order for ICBC to better incorporate the future benefits of prospective adjustments into the actuarial rate indication analysis.

The Commission Panel found that ICBC had a history of over-estimating forecast operating expenses. Further, ICBC acknowledged that expected compensation costs in PY 2010 may be lower than forecast in the Application. The Commission Panel concluded that an additional 0.5 percent reduction should be made to customer rates for PY 2010.

ICBC's Plan Addressing Basic Insurance Excess Capital

The Commission Panel determined that ICBC's plan to address Basic Insurance capital in excess of 150 percent of the Minimum Capital Test, as required under Commission Order G-65-10, has been developed in accord with the Government May 18, 2010 letter of direction which requires a departure from the Capital Management Plan (MCP) directions in Order G-3-08 and the accompanying Decision dated January 9, 2008.

Marketing and Broker Services allocation

The Commission Panel approved ICBC's use of the Corporate Shared Services Ratio as the allocator for Marketing and Broker Services costs and for a name change to Marketing Communication.

2.0 INTRODUCTION

2.1 The Application

ICBC applied on May 31, 2010 pursuant to sections 59 to 61 of the *Utilities Commission Act* (the UCA or the Act) and the *Insurance Corporation Act* (the ICA) for approval of a permanent 1.9 percent ($38.7 million in premiums) decrease in universal compulsory automobile insurance rates (Basic Insurance) for all renewal policies, with an effective date on and after November 1, 2010 (Policy Year 2010 or PY 2010). The Application also addresses ICBC's proposed plan to address Basic Insurance capital available in excess of 150 percent of the MCT calculation, which reflects the Government Directive of May 18, 2010. The Application also requests approvals for changes to the Marketing and Broker Service Department filing, as directed by the Commission Order G-3-08 (the Application).

The Application was filed as a Streamlined Revenue Requirements Application (RRA) pursuant to the regulatory process established by the Commission in its April 2010 Decision G-65-10.

2.2 Applicable Legislative Context

In addition to the applicable sections of the UCA and the ICA, Basic Insurance rates are to be determined in accordance with the following regulatory requirements:

Special Direction IC2 to the BC Utilities Commission, BC Regulation 307/2004, as amended, (Special Direction IC2) requires the Commission to fix Basic Insurance rates:

- On the basis of accepted actuarial practice.
- To maintain relatively stable and predictable rates.
- In a manner that recognizes and accepts actions taken by ICBC in compliance with Government Directives issued to ICBC.

The following two government directives issued to ICBC pursuant to section 3(1)(c.1) of Special Direction IC2 specifically impact the current Application:

(1) Government Directive of April 19, 2010 directs ICBC to undertake its proposed Transformation Program (TP), which is aimed at updating the systems and processes in place at ICBC. All TP costs incurred up to a specified amount are to be allocated to Optional Insurance, and accordingly there is no impact on Policy Year 2010 Basic Insurance rates.

(2) Government Directive of May 18, 2010 requiring ICBC to continue to apply the Basic Insurance Capital Management Plan except with respect to the release of capital. The current CMP was approved by the Commission pursuant to Order G-3-08. Basic Insurance capital in excess of the CMP management target that might otherwise have been released in PY 2010 will instead be subject to the conditions specified in the May 18, 2010 Directive.

The Commission provided comments with respect to potential risks to Basic Insurance of the Transformation Program in Commission Letter L-61-10, as part of its ongoing review of ICBC's Information Technology programs.

2.3 Factors Driving the Proposed 1.9 Percent Rate Decrease

ICBC's Policy Year 2010 Actuarial Rate Indication comprises of the following seven components which lead to the proposed 1.9 percent rate decrease:

Line No.	Components	% Impact*
1	PY 2007 Loss Cost Forecast Variance	-5.2
2	Loss Trend to PY 2010 and Prospective Adjustments	+1.7
3	Trend in Average Premium	+1.3
4	Change in investment Income	-1.2
5	Change in Operating Expenses	+1.5
6	Change in Capital Provisions	-0.8
7	Other	+0.8
8	**PY 2010 Actuarial Rate Indication**	-1.9
**Percentage Points of PY 2010 indication rate change*		

(Exhibit B-2, p. 3-2, Figure 3.1)

2.4 Decision Overview

Sections 3, 4, and 5 address the three areas of concern identified by the Commission Panel in relation to the PY 2010 Revenue Requirements.

Section 3 addresses a concern with respect to the growth in Basic Insurance excess capital and its relationship with the rate indication. The Commission notes that the MCT ratio has grown very quickly and to a level in excess of the management target, which in turn, in the view of the Commission Panel, raises concerns about intergenerational equity issues for policyholder.

Section 4 addresses the concern with respect to the $80 million increase in operating expenses since 2006 and related concerns with respect to ICBC's forecasting methodologies.

Section 5 addresses the concerns with the impact that the CMP has on the level of growth in Basic Insurance Excess Capital as reflected in the growth of the MCT ratio. Section 5 also addresses the requirement under Order G-65-10 for ICBC to file an application proposing a plan to deal with Basic Insurance capital in excess of that required for a MCT ratio of 150 percent.

Section 6 covers the Marketing and Broker Services filing.

Section 7 addresses the Insurance Bureau of Canada's concern with the lack of intervener notification and consultation with regards to the Drivers Risk Premium program.

3.0 ACTUARIAL RATE INDICATION ANALYSIS

3.1 Background

In accordance with Special Direction IC2, Basic Insurance rates are based on the actuarial rate indication prepared in accordance with accepted actuarial practice. The Standard of Practice of the Canadian Institute of Actuaries requires the actuarial rate indication to provide for all costs for Basic Insurance in order for the business to remain financially sound.

ICBC states that accepted actuarial practice in Canada requires the data used in the preparation of the actuarial rate indication to be based on either subject experience or related experience. Subject experience has a significant and demonstrable bearing on the matter [subject] at hand such as premiums, claims, expenses and other data that is relevant. Related experience is information other than the subject experience that is analogous to the coverage under consideration, such as prospective adjustments. The analogous information permits the actuary to infer that, because the analogous information agrees with the subject information in some respects, it probably will agree in other respects as well. (Exhibit B-5, Attachment 4, Item 2)

The Application includes prospective adjustments to recognize factors that will have a bearing on the premiums, claims or expenses for the policy period in question but which otherwise cannot be captured by the actuaries through the development or trending processes used in preparing the rate indication. The Application includes two prospective adjustments. One is for the Harmonized Sales Tax that is to be effective July 1, 2010 and another for the enhancement of Intersection Safety Cameras (ISC). (Exhibit B-5, Attachment 4, Items 3, 4)

ICBC states that the rate indication represents the average percentage change to the current Basic Insurance policy premium that is needed to generate the required revenue to pay for expected future costs related to policies issued in a policy year. (Exhibit B-2, p. 3-1, para. 1) The actuarial rate indication is based on estimates of future costs, and accordingly there will likely be a variance between forecast and actual costs in a test period. A positive variance means that customers have paid more in policy premiums that was needed to provide for costs related to that policy year. ICBC reported a positive variance of $49.9 million, $44.1 million, and $221.3 million in 2007, 2008 and 2009 respectively and the Application forecasts a positive variance of $66.2 in 2010. (Exhibit B-6, Duck IR 6.0)

ICBC operates in a closed system, therefore any variance between forecast and actual costs in a test period, either positive or negative, is captured in ICBC's Basic Insurance capital account. The Commission is required by Section 3(1)(c) of Special Direction IC2 "…[to] fix [Basic Insurance] rates on the basis of accepted actuarial practice…". (Exhibit B-5, Attachment 5, p. 1) Special Direction IC2 also requires the Commission to set rates in a way that will allow ICBC to maintain Basic Insurance capital available equal to at least 100 percent of MCT. Commission Order G-3-08 required ICBC to achieve and maintain a management target MCT ratio of 130 percent to provide the necessary degree of risk mitigation in order to ensure that ICBC's MCT ratio did not fall below the regulatory minimum 100 percent in subsequent years. As at December 31, 2009, ICBC's Basic Insurance capital account was $1,579.3 million. The resulting MCT ratio is 162.4 percent, $315 million in excess of the capital required to achieve a 130 percent MCT ratio. ICBC's Basic Insurance MCT ratio is forecast to reach 168.5 percent by the end of 2010, $381.5 million in excess of the management target ratio requirement. (Exhibit B-6, Duck IR 6.0)

3.2 Submissions

Insurance Bureau of Canada (IBC) expresses concern that some of the statistics and data underlying the actuarial calculations may not be sound as ICBC's reserve (excess capital) has continued to grow. (Exhibit C1-5, p. 2, Section (b)) IBC finds it troubling that ICBC is not better able to identify certain claims initiatives that are having a positive effect on claims costs and is concerned that savings are not being passed along to consumers in a timelier manner. (Exhibit C1-5, p. 2, Section (c))

British Columbia Old Age Pensioners' Organization *et al.* (BCOAPO) expressed concerns about ICBC's trend methodology and with the upward trend in the growth of the Basic Insurance excess capital account. It also submitted concerns with ICBC identifying unexpected inflation as its biggest risk. (Exhibit C2-3, p. 3)

During the Review Working Session held on June 17, 2010 questions were raised as to whether part of the growth in the Basic Insurance excess capital account is the result of ICBC's decision not to incorporate a number of factors, including claims handling initiatives, and some potential prospective adjustments into the trend analysis. (Exhibit B-5, Appendix 4)

ICBC's Reply reiterates much of its Application evidence to reinforce its view that the actuarial rate indication is unbiased and appropriate. ICBC states that prospective adjustments are based on related experience, and it would be inconsistent with accepted actuarial practice to make a prospective adjustment in the absence of related experience. (ICBC Reply, p. 24, para. 50)

ICBC has explained that the increase in the Basic Insurance capital account is due to events in the financial markets and the favourable emergence of loss costs as a result of reduced claims (ICBC Reply, p. 41, para. 94), and the increase is not driven by the lack of inclusion of certain prospective adjustments. (ICBC Reply, p. 24, para. 51)

ICBC states that events in the financial markets affect the Basic Insurance capital account due to the new 2007 accounting standards for financial instruments. ICBC's investments in bonds and equities are now measured at fair market value, which results in the determination of the Basic Insurance capital account valuation being very sensitive to changes in investment yields, equity prices and interest rates. (ICBC Reply, p. 41, para. 94)

ICBC explains that the actual claims cost experience achieved during the past few years has been significantly better than the claims costs forecast in 2007, resulting in a 5.2 percent variance in the PY 2007 Loss Cost Forecast. ICBC states that the primary reasons are due to favourable weather, the impact of a slow economy and the impact of certain claims initiatives that have reduced costs. ICBC further states that there are limits to the accuracy of the claims cost forecast to the extent that there is uncertainty inherent in any estimation process where the outcomes of events are yet to occur.

ICBC submits that it has modified its actuarial rate indication analysis methodology, as directed by the Commission in Order G-3-08, by developing a more refined premium trend model that takes into account changes in the mix of policy holders by rating factor (e.g. splitting personal and commercial lines of business). (ICBC Reply, p. 25, para. 55)

During the Review Working Session there were a number of questions raised as to whether ICBC has adequately incorporated a number of factors including claims handling initiatives, and some potential prospective adjustments into the trend analysis. ICBC states that the impacts of individual claims handling initiative cannot be isolated due to multiple initiatives and overlapping time periods. (Exhibit B-6, IBC IR 1.1) ICBC has recognized the impacts of the expanded and enhanced claims initiatives as they influenced the Bodily Injury Severity trend. (ICBC Reply, p. 18, para. 34)

ICBC states that it included a prospective adjustment in PY 2010 for the harmonized sales tax and the upgrades to the Intersection Safety Camera program implemented during PY 2010. ICBC determined that it would be inappropriate to make prospective adjustments for the Distracted Driver Program, Road Safety Initiatives, and the completion of the Canada Line and the Sea-to-Sky Highway as no related experience was available to use in estimating the impact on claims. ICBC states that road improvements and infrastructure projects have taken place in the past and their impact is embedded in the subject experience, which results in some level of improvement being forecast as part of the loss trending process. (ICBC Reply, p. 24, para. 51)

3.3 Commission Panel Findings

The Commission Panel notes BCOAPO's concern with ICBC identifying inflation as its biggest risk and recognizes that while rapid inflation may not be likely in Canada during the test period, a sustained increase in the rate of inflation, even if small, could result in a significant increase in the cost or value of unpaid claims. The Commission Panel considers that inflation is identified as a key risk not necessarily because it is expected to occur, but because if it were to occur it could have a significant impact on the Corporation's financial viability.

The Commission Panel also notes BCOAPO's concern that the trend model used by ICBC may be inappropriate. The Commission Panel recognizes the inherent uncertain nature in any estimate and notes that ICBC has modified its methodologies.

The Commission Panel further notes the concerns of IBC and BCOAPO that some of the statistics and data underlying the actuarial calculation may not be sound. The Commission Panel shares those concerns, and is not persuaded that the growth in the Basic Insurance capital account is solely due to fortuitous circumstances, but rather considers that at least a portion of the capital growth is likely due to shortcomings in ICBC's historic forecasting methodologies.

The Commission Panel recognizes that the impacts of the overall claims handling initiatives have had a favorable impact on the PY 2010 actuarial rate indication due to the inclusion of lower expected trend severity and lower rates of settlement and adjustments than the previous filing. The Commission Panel understands the requirement for related experience in order for a prospective adjustment to be made in accordance with Accepted Actuarial Practice. However, the Commission Panel does have some concern that the trend analysis may not be incorporating these positive factors in a timely manner, but rather with an inherent lag period after the initiatives have demonstrated savings.

The Commission Panel expects ICBC to increase its efforts to obtain related experience data in order to better incorporate the future benefits for prospective adjustments into the actuarial rate indication analysis and to reasonably anticipate and incorporate them into the actuarial trend in future revenue requirements applications, whenever possible.

Specifically for the 2011 policy year revenue requirements filing, ICBC is directed to include additional information indicating, in simple terms, how the impacts of the Distracted Drivers Campaign, Road Safety Initiatives (including the improvements to the Sea-to-Sky highway and completion of the Canada Line transit link), and Claims Initiatives are treated in the actuarial trend analysis.

The Commission Panel expects that the modifications to ICBC's forecasting methodologies may increase the accuracy of forecasts and ultimately reduce the variance between forecast and actual costs incurred. The Commission will continue to monitor ICBC's forecast and actual results and the impact which significant differences have with respect to the Basic Insurance capital account and the related issues of intergenerational equity and rate stability.

The Commission notes that the MCT ratio has grown quickly to a level in excess of the management target, which in turn, in the view of the Commission Panel, raises concerns about intergenerational equity issues for policyholders.

Notwithstanding these concerns, the Commission Panel finds ICBC's actuarial rate indication evidence to be adequate support for the PY 2010 RRA, except in relation to Operating Expenses as discussed in Section 4.0 of these Reasons for Decision.

4.0 OPERATING EXPENSES

4.1 Background

Corporate operating expenses, excluding costs of the Transformation Program and the Olympic Sponsorship Program, are split between Basic and Optional Insurance based on Commission approved financial allocation ratios. ICBC's PY 2010 forecast total corporate operating expenses represent approximately 15 percent of its total costs, and are forecast to be $80 million greater than actual 2006 expenses, $52 million of the $80 million increase is allocated to Basic Insurance, which equates to an annual average increase of approximately 3.8 percent from 2006 to PY 2010 and a corresponding 1.5 percent impact on the PY 2010 rate indication. (Exhibit B-2, p. 7A-1. para. 2) ICBC states that the increase in operating expenses above the rate of inflation (the Canadian inflation rate forecast for CPI used by ICBC is 2.23 percent) is attributable to market pressures on compensation, additional demands on ICBC's business, and the need for reinvestment in the business. (Exhibit B-2, p. 7A-1, para. 2 and p. 7-1, para. 1)

The three components impacting the $80 million increase in operating expenses are Base Operating Expenses, Government Initiatives and Unique Items as described in Exhibit B-2, p. 7-4, para. 10-14.

4.2 Submissions

All Interveners express some level of concern with the $80 million increase in operating expenses and noted the existence of some form of systematic upward bias in ICBC's forecasting.

BCOAPO submits that the growth in operating expenses suggests that ICBC has not made much of an effort in controlling costs and further submitted that the evidence seems to indicate corporate operating expenses have been systematically biased upward. (Exhibit C2-3, Part 2)

IBC submits that ICBC's operating expenses may be overestimated, especially in the area of Management and Confidential (M&C) full time employees (FTEs), and states that the 1.9 percent rate decrease might not be great enough given that actual costs have been consistently lower than forecast. (Exhibit C1-5, Section (b))

Mr. Duck submits that base operating costs are forecast to rise by 3.7 percent, which is greater than the 2.23 percent inflation forecast used by ICBC and further submits that nowhere in the Application has ICBC incorporated a "productivity" factor into its forecast. (Exhibit C3-3, p. 1, para. 1-2),

ICBC responds to Intervener concerns by restating portions of its evidence and submits that its proposed operating expenses reflect a realistic assessment of its requirements. (ICBC Reply, p. 39, para. 86)

4.3 Analysis

ICBC's forecast operating expenses have been higher than actual each year since ICBC began to allocate costs between Basic and Optional Insurance in 2003. (Exhibit B-6, IBC IR 21.1) In the period 2006 to 2009 ICBC has experienced an average favourable operating expense variance of 2.8 percent (Exhibit B-6, BCUC IR 38.1), which it states is a result of a number of one-off items. (Exhibit B-2, p. 7C-2, para. 9-10)

ICBC's actual operating expenses were $27 million, $6 million, $15 million, and $13 million less than forecast in 2006, 2007, 2008 and 2009 respectively (Exhibit B-2, p. 7C-1, Figure 7C.1), which the Commission Panel views as being more representative of a trend of overestimating than a simple series of one-off items. ICBC states that a 2.8 percent reduction to operating expense would translate to a further 0.5 percent decrease in the Basic Insurance rate indication for PY 2010. (Exhibit B-6, BCUC IR 38.3.1)

The Commission Panel notes that of the $80 million increase in total corporate operating expenses, $55 million relates to increased overall compensation expense, of which $18 million is attributable to forecast PY 2010. ICBC explains the increase is a result of higher compensation rates, a change in the number of FTEs, and/or a change in the employee mix. (Exhibit B-2, p. 7A-3, para. 7)

From 2006 to 2009 ICBC has experienced an actual average growth rate in compensation expense of 3.4 percent. ICBC is forecasting an increase of 4.6 percent In PY 2010. (Exhibit B-6, BCUC IR 30.1) ICBC states that one of the most significant factors driving the compensation expense increase in PY 2010 is the forecast addition of 71 new FTEs, an increase of 7.3 percent. (Exhibit B-6, BCUC IR 31.1)

ICBC states that the growth in FTEs between 2006 and PY 2010 amounts to combined growth rate of 143 FTEs, an increase of less than 3 percent. (Exhibit B-2, p. 7A-5, para. 14) The Bargaining Unit (BU) has reduced their number of FTEs by 78 during this period while the M&C group, who are compensated at a higher level, has increased by 205 FTEs. ICBC has experienced an actual annual increase of FTEs in the M&C group between 2006 and 2009 of 5.3 percent and is forecasting an increase of 7.3 percent in PY 2010, 2 percent higher than the average actual annual increase. The Commission Panel notes that in the past ICBC has overestimated the number of FTE additions as evidenced in 2008 when the actual number of FTE additions was 59 less than forecast. (Exhibit B-2, p. 7C-3, Figure 7C.2)

ICBC states that "the 2010 forecast was prepared based on the best estimate at the time using the information available." ICBC states:

> "The current year-to-date results indicate external influences may result in lower compensation cost due to lower staffing requirements resulting from lower claims volumes and extended hiring timelines for technical staff. In addition, a change in the discount rate for the pension plans is expected to reduce the pension expenses. As in previous years, these external influences and changes in the discount rate will cause a small variance between the 2010 forecast and actual operating expenses."
>
> (Exhibit B-6, BCUC IR 38.1)

ICBC's Information Response further increases the Commission's concern that PY 2010 corporate operating expenses are over-estimated.

4.4 Commission Panel Findings

The Commission Panel finds that ICBC's history of over-estimating forecast operating expenses, coupled with the acknowledgement that expected compensation costs may be lower than forecast, leads to the conclusion that an adjustment should be made to the rate indication for PY 2010. The Commission Panel accepts ICBC's evidence that a 2.8 percent reduction in PY 2010 operating expenses would translate to a 0.5 percent decrease in the 2010 actuarial rate indication, and considers that 2.8 percent is a reasonable estimate of the likely extent of ICBC's over-estimated operating expenses for PY 2010. **Accordingly, the Application to decrease Basic**

Insurance rates by 1.9 percent for the 2010 Policy Year is modified to require a decrease of 2.4 percent, comprising the 1.9 percent applied-for rate reduction plus a further 0.5 percent rate reduction for Commission determined adjustments to operating costs.

5.0 CAPITAL PROVISIONS

5.1 Background

The Office of the Superintendent of Financial Institutions (OSFI) prescribes a MCT ratio to be maintained by financial institutions under the jurisdiction of OSFI. The OSFI definition of MCT, as amended or replaced from time to time, is applicable to ICBC's Basic Insurance by virtue of Special Direction IC2 of the Government of BC, which requires the Commission to set rates for Basic Insurance to allow ICBC to maintain capital available in relation to Basic Insurance equal to at least 100 percent of the (MCT) ratio. The Commission, in Order G-86-06, determined that the 100 percent MCT ratio should be considered a minimum.

Following the review of ICBC's 2007 RRA, the Commission approved a Basic Insurance CMP for ICBC in Order G-3-08. The main objective of the CMP is to maintain capital levels that are adequate to protect policyholders from financial risk, while maintaining relatively stable and predictable rates. The CMP set the management target MCT ratio for Basic Insurance at 130 percent. The CMP also contained *a Capital Build Provision* to gradually grow the MCT ratio from its then current level to 130 percent, a *Capital Release Provision* to gradually release capital based on a predetermined formula when the MCT ratio is in excess of 130 percent, and a *Capital Maintenance Provision* to allow ICBC to maintain an MCT ratio of 130 percent in the face of inflationary pressures and growth in the number of policies written.

In order to maintain a 130 percent MCT ratio, ICBC would require a Basic Insurance capital balance of $1,264 million on December 31, 2009 and $1,287 million on December 31, 2010. ICBC's actual accumulated capital balance on December 31, 2009 was in excess of the required $1,264 million by $315 million, that with the excess forecast to grow to $381 million by December 31, 2010, resulting in MCT ratios of 162.4 percent and 168.5 percent respectively. (Exhibit B-6, Duck IR 6)

In its April 2010 Decision on the Streamlined Regulatory Process (Order G-65-10) the Commission directed the following: *Within 90 days of any calendar year end when ICBC's MCT ratio for that year exceeds 150 percent, ICBC is to file an application proposing a plan to deal with the excess.*

On May 18, 2010, a Government Directive regarding Basic Insurance excess capital was issued pursuant to Order in Council (OIC) 287 directing a departure from the Commission-approved CMP regarding the *Capital Release Provision*. The Directive sets conditions respecting when capital is to be released, the amount to be released, and when ICBC must retain capital for the purposes of offsetting future rate increases.

In the Application ICBC proposed to apply the provisions of the CMP and the Government Directive as follows:

<u>Capital Build Provision</u>

ICBC determines that no Capital Build Provision is required for PY 2010 as ICBC's Basic Insurance MCT ratio was 162.4 percent on December 31, 2009 which exceeds the management target MCT ratio of 130 percent. (Exhibit B-2, p. 3-28, para. 90-91)

Capital Release Provision

The May 18, 2010 Government Directive requires that when the actuarial rate indication is zero or negative, as in the case of the Application, no capital is to be released; as such ICBC has eliminated the Capital Release Provision for PY 2010. ICBC has retained the full Basic Insurance capital account in the Corporation to be used to offset future Basic Insurance rate increases in order to enable relatively stable and predictable rates.

Capital Maintenance Provision

ICBC determines that a Capital Maintenance Provision of $30.8 million is required in the actuarial rate indication for PY 2010 to account for growth in required capital over time. (Exhibit B-2, p. 3-28, para. 92)

5.2 Submissions

None of the Interveners expressed any issues with the elimination of the Capital Build Provision. Concerns were raised regarding the elimination of the Capital Release Provision and whether the Capital Maintenance Provision should be applied in cases where the MCT is significantly in excess of the 130 percent management target.

Mr. Duck suggests that the Commission should put the detail of the Government Directive to a separate more comprehensive, public proceeding including some form of public input. (Exhibit C3-3, p. 5, para. 5) Mr. Duck further submits that ICBC should apply the CMP without reference to the Government Directive, effectively applying the Capital Release Provision. (Exhibit C3-3, p. 10, Section III, para. 3) In making this comment, Mr. Duck did not address whether the Commission had any jurisdiction to override or amend Governments Directions.

BCOAPO submits that when ICBC has capital available surplus to its 130 percent MCT target, no Capital Maintenance Provision should be included in the actuarial rate indication. (Exhibit C2-3, p. 3, para. 2) BCOAPO did not include any evidence or submission with respect to whether excluding the Capital Maintenance Provision would be compliant with accepted actuarial practice.

Family Insurance Solutions advocates that ICBC should continue to contribute in full to the MCT for Basic Insurance as required by Special Direction IC2. (Exhibit C6-2)

IBC made no submissions with respect to Capital Provisions or the MCT ratio.

ICBC submits that the real issue regarding Basic Insurance excess capital is not what caused it to accumulate, but rather how to address the accumulation. (ICBC Reply, p. 41, para. 94) ICBC believes that question has been answered by the Government Directive and submits that by complying with the Directive ICBC has satisfied the Commission's direction, pursuant to Order G-65-10, to prepare a plan to address Basic Insurance excess capital. (ICBC Reply, p. 45, para. 101)

ICBC submits that the Government Directive Regarding Basic Excess Capital precludes the Commission from directing ICBC to remove the Capital Maintenance Provision from the PY 2010 rate indication. (ICBC Reply, p. 50, para. 114)

ICBC further submits that the purpose of the Capital Maintenance Provision is to maintain the MCT ratio in the face of inflationary pressures and growth in the number of policies written and as such is considered by the actuaries as a necessary permanent component of the rate. (ICBC Reply, p. 47, para. 107) ICBC addresses this issue in its evidence, and states that "(s)etting rates in a way that omits a cost element is inconsistent with actuarial practice." (Exhibit B-5, Attachment 5, p .3)

ICBC quotes Special Direction IC2 which requires the Commission "to ensure that increases or decreases in [Basic] insurance are phased in such a way that those rates remain relatively stable and predictable." (ICBC Reply, p. 49, para. 111) ICBC submits that rates set without accounting for the Capital Maintenance Provision would be deficient to the extent of -1.5 percent for PY 2010. ICBC submits that If the capital maintenance provision were to be suspended as BCOAPO suggests the reintroduction of the Capital Maintenance Provision in subsequent years when excess capital had been eroded would result in a more significant rate increase in that year than would otherwise have been the case. (ICBC Reply, p. 49, para. 112-113)

5.3 Commission Panel Findings

Capital Release Provision

The Commission Panel finds that the Commission does not have the jurisdiction to override the May 27, 2010 Government Directive and therefore accepts that a Capital Release Provision is appropriately excluded from the determination of the PY 2010 rate decrease.

The Commission Panel also finds that given the nature of the direction, it is not in the public interest to initiate a process to examine the merits of the Government's letter of direction, as proposed by Mr. Duck, and will therefore not undertake such a process.

Capital Maintenance Provision

The Commission Panel agrees with the evidence and submissions of ICBC that a Capital Maintenance Provision is a required element to be included in determining the cost of Basic Insurance. The inclusion of the Capital Maintenance Provision is an appropriate element in determining the PY 2010 rate indication and helps maintain relatively stable and predictable rates as legislated under Special Direction IC2.

ICBC's plan to address Basic Insurance excess capital greater than 150 percent of minimum capital required as filed in the Application is accepted, including continuation of the capital maintenance provision and, pursuant to the Government letter of direction of May 18, 2010, retention of the Basic Insurance capital in excess of the management MCT target.

6.0 MARKETING AND BROKER SERVICES ALLOCATION

6.1 Background

In Order G-9-05 the Commission directed ICBC to provide information at a more detailed level for the allocation of costs relating to Marketing and Broker Services. In its 2005 RRA, ICBC filed the requested information using Premiums Written as the allocator for general departmental costs and direct allocation for advertising campaign costs.

The Commission, in Decision G-86-06, encouraged ICBC to consider whether there was a better way to allocate these costs. In the 2007 RRA, ICBC re-examined the allocation and concluded that the Marketing and Broker Services costs were allocated appropriately according to the principles of cost causality and that no further means to allocate these costs be considered. The Commission, in Decision G-3-08 on that application, ordered ICBC to consider alternative means to allocate these costs at the first opportunity.

On September 20, 2008, ICBC filed its Marketing and Broker Services Allocation Filing, which is being considered as part of this Application. ICBC proposes both a change in the allocator for Marketing and Broker Services from Premiums Written to Corporate Shared Service Ratio, and to change the name to Marketing Communication to better reflect the change in focus of the department and to provide greater transparency with respect to the department's role.

In the filing ICBC considered the *Corporate Shared Services Ratio* and *Work Effort* as two alternative allocators in addition to the *Premiums Written allocation*. ICBC concluded that the most appropriate allocator for Marketing and Broker Services is that based on allocating the departmental costs according to the Corporate Shared Services Ratio, both from the perspective of simplicity and because it has a stronger causal link with the current departmental function, uses objective data, and does not require periodic updating. The net dollar impact of this allocation is a transfer from Optional Insurance to Basic Insurance of $36,000. (Exhibit B-2, Appendix 7F, p. 13, para 36)

6.2 Submissions

IBC was the only Intervener to comment. IBC submits that it is not possible to assess alternative allocators before the Commission rules on road safety and branding issues raised by IBC, and that all advertising and branding costs within the Marketing and Broker Services department should be allocated 100 percent to Optional Insurance. (Exhibit C1-5, p. 4-5, Section (g))

ICBC submits that the allocation issues raised by IBC fall outside the proper scope of this proceeding and its arguments are based on supposition and do not address, in a meaningful way, ICBC's evidence in support of the selection. (ICBC Reply, p. 58, para. 133, 134)

6.3 Commission Panel Findings

The Commission Panel notes IBC's concern that that all advertising and branding costs within the Marketing and Broker Services department should be allocated 100 percent to Optional Insurance, but finds that the submission is not supported by any evidence, and accordingly can be given little if any weight. The Commission Panel finds ICBC's proposed use of the Corporate Shared Services Ratio to be a reasonable allocator for Marketing and Broker Services and finds the proposed name change to Marketing Communication to be acceptable.

ICBC's proposed use of the Corporate Shared Services Ratio as the allocator for Marketing and Broker Services costs and proposed name change to Marketing Communication as set out in Appendix 7F of the Application are approved.

7.0 DRIVER RISK PREMIUMS

7.1 Background

ICBC proposes to file a revised approach to Phase 2 of the Driver Risk Premium (DRP) program for approval by the Commission in its 2011 rate design application. In the interim, ICBC has stated that it will not undertake any new measures to replace the premiums that would have been charged had the DRP Phase 2 been implemented as originally contemplated.

In the 2007 Rate Design Application ICBC projected that, when fully operational in 2012, annual revenues from the DRP program would be in the range of $40 to $60 million. The estimated revenues for 2010 and 2011 included in this Application are $21.0 and $26.0 million respectively, and according to ICBC are less than e arlier forecasts due to lower conviction counts than previously projected combined with the delay in the implementation of DRP Phase 2.

On March 15, 2010, ICBC filed its Rate Design Update and explained, among other things, the status of the DRP program including the Government letter addressing DRP. ICBC intends to file its Driver Record Rating Model Rate Design Application in 2011, which will address its outstanding commitments regarding DRP.

7.2 Submissions

IBC expressed concern that Interveners were not consulted regarding the decision not to proceed with DRP Phase 2 as originally contemplated. (Exhibit C1-5, p. 3, Section (d))

7.3 Commission Panel Findings

The Commission Panel notes IBC's concerns that Interveners were not notified of ICBC's decision not to proceed with DRP Phase 2 as originally contemplated. The Commission Panel strongly encourages ICBC to notify interested parties in future cases when ICBC contemplates a major change from a Commission determination to a public process.

The Commission Panel accepts ICBC's proposal but is concerned with the delay in implementing Phase 2 of the DRP program. The Commission Panel strongly encourages ICBC to file its Driver Record Rating Model Rate Design Application no later than December 31, 2011 and advises ICBC to address its outstanding commitment regarding DRP Phase 2 in that Application.

DATED at the City of Vancouver, in the Province of British Columbia, this 24th day of November 2010.

_____*Original signed by:*_________________
A.W.K. ANDERSON
PANEL CHAIR

_____*Original signed by:*_________________
L.A. O'HARA
COMMISSIONER

_____*Original signed by:*_________________
L.F. KELSEY
COMMISSIONER