British Columbia Utilities Commission

Sixth floor, 900 Howe Street
Vancouver, BC Canada V6Z 2N3
TEL: (604) 660-4700
BC Toll Free: 1-800-663-1385
FAX: (604) 660-1102

ORDER NUMBER
G-71-17

IN THE MATTER OF
the *Utilities Commission Act*, RSBC 1996, Chapter 473

and

the Insurance Corporation Act, R.S.B.C. 1996, Chapter 228, as amended

and

Insurance Corporation of British Columbia
An Application for Approval of the Revenue Requirements for Universal Compulsory Automobile Insurance
Effective November 1, 2016

BEFORE:
D. A. Cote, Commissioner/Panel Chair
B. A. Magnan, Commissioner
R. I. Mason, Commissioner

on May 16, 2017

ORDER

WHEREAS:

A. On August 25, 2016, the Insurance Corporation of British Columbia (ICBC) filed an application to the British Columbia Utilities Commission (Commission) for its 2016 Revenue Requirements for Universal Compulsory Automobile Insurance (Basic insurance), seeking a Basic insurance rate increase of 4.9 percent for the policy year commencing November 1, 2016 (PY 2016) (Application);

B. In the Application, ICBC also requests the following:

   i. Approval of a proposed allocation methodology for the deferred premium acquisition cost (DPAC) between Basic insurance and Optional insurance (DPAC Allocation Methodology); and

   ii. Approval to discontinue the quarterly reporting requirement for government initiatives while continuing to report these initiatives annually as a chapter in each revenue requirements application (Government Initiatives Reporting Requirement);

C. By Orders G-142-16 and G-163-16, the Commission established a Regulatory Timetable for the review of the Application and approved a Basic rate increase of 4.9 percent on an interim basis for PY 2016, pending approval of a permanent rate;

D. On December 16, 2016, the Lieutenant Governor in Council issued Order in Council No. 960, amending *Special Direction IC2 to the British Columbia Utilities Commission (Special Direction IC2)*, which adds that for

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the PY 2016, the Commission must issue its final general rate change order by January 16, 2017 and the PY 2016 rate change must not exceed 4.9 percent (OIC 960/16);

E. By Order G-2-17 dated January 12, 2017, in accordance with OIC 960/16, the Commission approved a 4.9 percent Basic insurance permanent rate increase for PY 2016;

F. By Order G-23-17 dated February 24, 2017, the Commission ordered that the remaining process would be scoped to providing argument on the two outstanding requests from the Application: (i) DPAC Allocation Methodology and (ii) Government Initiatives Reporting Requirement;

G. ICBC filed its Final Argument on March 6, 2017. Registered interveners filed their Final Arguments by March 16, 2017. ICBC filed its Reply Argument on March 27, 2017; and

H. The Panel reviewed and considered the evidence on record and the final arguments for the Application.

NOW THEREFORE for the reasons set out in Appendix A of this Order, the British Columbia Utilities Commission orders as follows:

1. The proposed allocation methodology for the deferral premium acquisition cost between Basic insurance and Optional insurance is approved.

2. The proposal to discontinue the quarterly reporting requirements for government initiatives and continue reporting government initiatives annually as a chapter in each revenue requirements application is approved.

DATED at the City of Vancouver, in the Province of British Columbia, this *16th* day of May, 2017.

BY ORDER

Original signed by:

D. A. Cote
Commissioner/Panel Chair

British Columbia Utilities Commission

IN THE MATTER OF

Insurance Corporation of British Columbia
An Application for Approval of the Revenue Requirements for
Universal Compulsory Automobile Insurance
Effective November 1, 2016

REASONS FOR DECISION

May 16, 2017

Before:
D. A. Cote, Commissioner/Panel Chair
B. A. Magnan, Commissioner
R. I. Mason, Commissioner

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An Application by the Insurance Corporation of British Columbia
for Approval of the Revenue Requirements for Universal Compulsory Automobile Insurance
Effective November 1, 2016

REASONS FOR DECISION

1.0 BACKGROUND

On August 25, 2016, the Insurance Corporation of British Columbia (ICBC) filed an application to the British Columbia Utilities Commission (Commission) for its 2016 Revenue Requirements for Universal Compulsory Automobile Insurance (Basic insurance), seeking a Basic insurance rate increase of 4.9 percent for the policy year commencing November 1, 2016 (PY 2016) (Application or RRA). By Order G-2-17 dated January 12, 2017, in accordance with Order in Council No. 960 dated December 16, 2016, the Commission approved a Basic insurance permanent rate increase of 4.9 percent for PY 2016.

In addition to approval of the general rate increase ICBC requests two other incidental approvals as follows:[1]:

i. Approval of a proposed allocation methodology for the deferred premium acquisition cost (DPAC) between Basic insurance and Optional insurance (DPAC Allocation Methodology).

ii. Approval of a proposal to discontinue the quarterly reporting requirement for government initiatives while continuing to report annually as a chapter in each revenue requirements application (Government Initiatives Reporting Requirement).

By Order G-23-17 dated February 24, 2017, the Commission ordered that the scope for the remaining process would be restricted to providing argument on the two outstanding requests from the Application: (i) DPAC Allocation Methodology and (ii) Government Initiatives Reporting Requirement.

ICBC filed its Final Argument on March 6, 2017. Registered interveners filed their Final Arguments by March 16, 2017. ICBC filed its Reply Argument on March 27, 2017.

Accordingly, the Panel addresses the two scoped items in these reasons for decision.

[1] Exhibit B-1, p. iii.

2.0 DEFERRED PREMIUM ACQUSITION COST ALLOCATION METHODOLOGY

ICBC proposes to change its current process of measuring the deferred premium acquisition cost (DPAC) for Basic insurance separate from and independent of Optional insurance, to measuring DPAC for Basic and Optional insurance on a combined basis and then allocating the DPAC provision back to each. ICBC submits this change is driven by financial reporting requirements with income and capital transfers from Optional insurance to Basic insurance (as opposed to capital transfers only) and does not impact the rate indication or the Outlook Minimum Capital Test (MCT) Ratio.[2]

ICBC explained its DPAC rationale as follows:

> DPAC, represented by commissions and premium tax expenses, is a balance sheet asset that relates directly to the written policies. To the extent that these costs are recoverable from margin within the unearned premiums at the end of the year, they are deferred and amortized to income over the remaining term of the related policies. If there is determined to be insufficient margin in the unearned premiums, the amount of the DPAC asset must be limited; and if there is determined to be an expected loss within the unearned premium then a related liability arises for the premium deficiency. The DPAC asset, or premium deficiency liability, are balance sheet items that are included in the calculation of the MCT ratio.[3]

ICBC provided calculations to show that Basic DPAC would be unaffected in PY 2016[4], and concluded that:

> ... ICBC's proposed allocation methodology for DPAC, which has been necessitated by the beneficial transfer of Optional insurance income to Basic insurance, ensures that the financial reporting requirements can be met while having no impact on the PY 2016 rate indication.[5]

ICBC further explained its rationale for the DPAC change in response to a Commission Information Request (IR) as follows:[6]

> The rate setting formula is based on a combination of the projected net costs and a capital provision (currently suspended per *Special Direction IC2*). Transferring capital does not materially impact the required rate, whereas a transfer of income, as has been directed, goes toward reducing the Basic insurance rate indication. Therefore, Optional insurance rates are being used to help fund the income transfers to Basic insurance.

ICBC provided examples demonstrating that in most scenarios Basic insurance would be exactly the same under the proposed allocation approach as compared to the direct calculation approach, and in some cases, would have a favourable impact on Basic insurance. ICBC states that there are no circumstances that would result in a smaller DPAC asset (or larger premium deficiency reserve liability) for Basic insurance resulting a weaker capital position.[7]

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[2] Ibid, p. iii.
[3] Exhibit B-1, pp. 3-5 to 3-6.
[4] Ibid, pp. 3-7.
[5] Ibid, pp. 3-8.
[6] Exhibit B-2, 2016.1 RR BCUC.20.1.
[7] Exhibit B-2, 2016.1 RR BCUC.20.3, 2016.1 RR BCUC.20.4, 2016.1 RR BCOAPO.1.1, 2016.1 RR TREAD.7.1.

2.1 Positions of the parties

Interveners

British Columbia Old Age Pensioners' Organization, Active Support Against Poverty, Council Of Senior Citizens' Organizations Of BC, Disability Alliance BC, and The Tenant Resource And Advisory Centre et al. (BCOAPO) submits it is satisfied the proposed allocation will not result in harm to Basic ratepayers as ICBC provided assurance of this in its IR responses. However, BCOAPO is still not clear as to why ICBC could not calculate a corporate DPAC for the purposes of International Financial Reporting Standards (IFRS), and continue to calculate separately the DPAC and deferred acquisition cost as ICBC does currently for regulatory purposes.[8]

Toward Responsible Educated Attentive Driving (TREAD) accepts ICBC's assertion that Basic insurance customers will be financially indifferent or better off, although there is a possibility that in future years there may be unfavourable Basic rate impacts.[9] TREAD also submits the Commission should have regard to the potential for the proposed change to complicate or obscure the required regulation of Basic insurance as an entity separate and distinct from Optional insurance.[10] Nonetheless, TREAD concludes that it does not oppose ICBC's proposed DPAC allocation methodology.[11]

Mr. Landale submits ICBC provided insufficient information and lacked clarity regarding the new DPAC methodology.[12] Mr. Landale questions ICBC's 2014-year financial reporting on the DPAC with reference to certain Service Plans. Further, Mr. Landale notes there is a discrepancy between the Application and ICBC's final arguments. Mr. Landale points out that in the application ICBC states the new allocation methodology would have no impact on the PY 2016 rate indication or the MCT Outlook ratio while in its final argument, ICBC states the proposed allocation methodology would have no impact on the PY 2016 rate indication only.

Mr. Landale states that the Panel must overcome the following four issues/arguments before granting approval of the new DPAC methodology:[13]

- Insufficient evidence regarding the IFRS financial reporting requirements to support the proposed allocation methodology;
- What is the specific allocation ratio that ICBC is requesting the Commission to approve?
- ICBC has used the proposed allocation methodology to calculate the MCT Outlook without the Commission's prior approval;
- Lack of discussion regarding the DPAC impact on the cost-per-policy in force as shown in Figure 6.5 of the Application. What else will be affected due to the new DPAC allocation methodology?

ICBC Reply

In response to BCOAPO, ICBC submits that using the proposed allocation methodology for all purposes is the reasonable approach. Maintaining consistency between the financial statements and presentation in regulatory

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[8] BCOAPO Final Argument, p. 1.
[9] TREAD Final Argument, paras. 18-19.
[10] Ibid, paras. 16, 20-24, 45.
[11] Ibid, para. 45.
[12] Landale Final Arguments, p. 9.
[13] Ibid, pp. 7-9.

filings, and avoiding "two sets of numbers", is beneficial for ease of understanding on the part of all stakeholders.[14]

Noting that TREAD does not oppose the allocation methodology, ICBC reiterates there are only two possible outcomes: (1) no difference in the Basic DPAC compared to the direct calculation or (2) larger Basic DPAC, and a corresponding improvement in ICBC's capital position.[15] Regarding TREAD's claim that the change will complicate and obscure the separate regulation of Basic Insurance, ICBC argues TREAD's submissions are aimed at the regulatory framework in which ICBC operates, rather than the DPAC allocation.[16]

In response to Mr. Landale, ICBC argues that Mr. Landale's submissions are based on a misapprehension of the facts and disagrees with them in their entirety stating[17]:

- ICBC's proposal is integral to IFRS compliance and it described the applicable guideline in its final submissions.
- ICBC's request is clear as stated in Chapter 3, paragraph 22 of the application.

  ICBC was transparent that it had determined Basic DPAC using the proposed methodology, and that there was no practical effect on Basic insurance policyholders.

2.2 Panel determination

The Panel approves the proposed allocation methodology for the deferral premium acquisition cost between Basic insurance and Optional insurance, noting that BCOAPO and TREAD are not opposed to ICBC's proposed DPAC allocation methodology.

The Panel has considered the following questions in determining ICBC's proposed DPAC allocation methodology:

i. Has ICBC demonstrated a need to change the DPAC allocation methodology?
ii. What are the implications to Basic insurance policyholders?

In previous years, only capital was transferred from Optional to Basic Insurance. Transfers from Optional to Basic insurance now involve both capital and income and is a material change. Because the Optional insurance income is now transferred to subsidize Basic insurance, potentially impacting Optional rates, the Panel finds a corporate allocation methodology is more reasonable as compared to calculating the DPAC separately for each line of business. Moreover, ICBC has provided evidence to support its position that Basic insurance policyholders would not be adversely affected by the DPAC allocation methodology. Given these circumstances, the Panel accepts the DPAC allocation methodology to be used in the 2016 RRA and in future rate applications.

Mr. Landale raises a number of issues he believes must be overcome prior to approval of the change in allocation methodology. ICBC has addressed each of these in its Reply Argument. The Panel accepts ICBC's explanations noting that Basic policyholders will not be disadvantaged by the change to the DPAC allocation methodology.

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[14] ICBC Reply, p. 2.
[15] Ibid, p. 2.
[16] Ibid, p. 3.
[17] Ibid, pp. 3-5.

3.0 GOVERNMENT INITIATIVES REPORTING

As a Crown corporation, ICBC is mandated to undertake certain initiatives on behalf of the government. The services provided by ICBC on behalf of the government are documented in the Service Agreement with Appendices updated and an Addendum prepared annually for changes or additions to the existing services (Service Agreement). Examples of these initiatives include BC Services Card; Refuse to Issue for Other Government Debt Programs; and Organ Donation Registry.[18] The costs of these programs are either recovered from Government with no impact on Basic insurance and/or funded by Basic insurance policyholders pursuant to *Special Direction IC2*.[19] ICBC also makes payments under the Road Safety MOU based on a fixed percentage of Basic premiums.

In the September 2009 Amended Application for a Streamlined Regulatory Process, ICBC proposed amending its Government Initiatives Reporting. ICBC's proposal included providing updated Service Agreement documents and reporting on any changes to the Traffic and Road Safety Law Enforcement Funding Memorandum of Understanding (Road Safety MOU) funding formula by May 31 each year. ICBC also committed to provide additional reporting on government initiatives on a quarterly basis. The Commission approved the 2009 application by Order G-65-10, after a public hearing process.[20]

In the ICBC 2016 RRA, ICBC applied for approval to discontinue the quarterly reporting requirement for government initiatives. ICBC commits to continue reporting on government initiatives on an annual basis as a chapter in future revenue requirements applications, including the Service Agreement documentation. ICBC states it will also include[21]:

- A listing identifying new Government Initiatives as part of the Service Agreement documentation.
- One-off items that fall outside the Service Agreement and the Road Safety MOU and as supported by a government directive.
- The updated Road Safety MOU, if the funding formula has changed.
- Summary updates on Government Initiatives over $1 million.
- For initiatives under $1 million, provide any changes since the last revenue requirements application in the form of an itemized list of programs and their planned budgets.

As rationale for ICBC's current Government Initiatives Reporting Requirement proposal to move away from quarterly reports, it provides the following:

- ICBC has filed 19 quarterly Government Initiatives Reports since the April 2010 Decision. The Commission has not provided comments or questions on any of these quarterly reports.
- Filing the Government Initiatives Report annually as a chapter would continue to provide the Commission with pertinent information on government initiatives and it would streamline compliance

[18] Exhibit B-1, Appendix 9 A, p. 2.
[19] Exhibit B-1, pp. 9-1 to 9-2.
[20] Order G-65-10 Insurance Corporation of British Columbia Application for an Order Specifying the Form and Content of, and Review Process for ICBC Universal Compulsory Automobile Insurance Revenue Requirements Applications Meeting Specified Criteria, Order G-65-10 with Reasons dated April 6, 2010.
[21] Exhibit B-1, pp. 9-5.

reporting, which was a recommendation contained in the November 14, 2014 Independent Review of BCUC Final Report (BCUC Core Review).

ICBC submits that in addition to the benefits of streamlining, the filing of government initiatives report annually will continue to provide transparency to the Commission and to interveners[22]. Moreover, ICBC also notes that even if the Commission were to disagree with new government initiatives, the Commission is not empowered to direct any change in the initiatives themselves. Government determines the need for the initiatives. The Commission's role, as defined by *Special Direction IC2*, is determining that rates are sufficient to cover the cost of these initiatives.[23]

3.1 Positions of the parties

<u>Interveners</u>

Mr. Landale disagrees with ICBC's rationale to discontinue quarterly reporting because the Commission did not provide any feedback or comments to ICBC. In his view the Commission has no obligation to ask questions or provide comments. Mr. Landale submits that all existing reporting agreements ICBC has with the Commission should continue in order to ensure continuity and transparency. Quarterly reporting provides the opportunity for independent review and timely oversight on government initiatives.[24]

TREAD is opposed to ICBC's proposed discontinuation of quarterly reporting on government initiatives and move to annual reporting within the already document-intensive annual RRA proceeding[25]. TREAD makes the following arguments in support of its position:

- ICBC provides no evidence to support a material cost or effort savings - there is not a compelling efficiency rationale to justify the change in frequency of reporting.[26]
- Under the current quarterly reporting, the Commission may identify any issues in a timely manner and request ICBC to take action to address the issue rather in its next revenue requirements cycle.[27]

BCOAPO is opposed to ICBC's proposal and provides the following submissions:[28]

- As the upward pressure continues on Basic insurance rates, it is in the public's best interest for the Commission and interveners to keep abreast of government initiatives throughout the year, as opposed to being subsumed within the much larger volume of information set out annually in the revenue requirements application.
- Given that OIC 960/16 truncated the ICBC 2016 RRA, and that the third-party review announced by the Ministry of Transportation and Infrastructure excludes intervener participation, the Commission should preserve all reporting requirements now in place to support a robust regulatory process, augmented by informed public interest participation.

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22 Exhibit B-2, 2016.1 RR RL.2.1.3
23 ICBC Final Argument, p. 6
24 Mr. Landale Final Argument, p. 9.
25 TREAD Final Argument, para. 46.
26 Ibid, paras. 35-37.
27 Ibid, paras. 33, 39.
28 BCOAPO Final Argument, pp. 3-4.

- Historically, ICBC did not report any one-off initiatives outside of the Service Agreement but this does not mean there will not be any one-off initiatives going forward which may carry cost implications.

ICBC Reply

In response to BCOAPO and TREAD, ICBC submits that reporting annually instead of quarterly will not, on its own, reduce the number of required employees or produce material savings. In its view the Commission should consider quarterly reporting on government initiatives as providing little additional value relative to reporting that occurs in revenue requirement proceedings. The frequency of reporting does not change the implications to Basic insurance policyholders in that government initiatives are outside the control of ICBC and the Commission.[29]

In response to Mr. Landale, ICBC submits that Mr. Landale's opposition to ICBC's proposal appears to be based on the premise that more frequent reporting is necessary to identify a "trend… requiring special questions or comments, with the view to correction or adjustment." ICBC submits that the nature of government initiatives is such that they do not give rise to a "trend". The Commission is required to fix Basic insurance rates sufficient to ensure that the costs of these initiatives are covered and has no jurisdiction to make "correction or adjustment" to government initiatives.

3.2 Panel determination

The Panel approves the proposal to discontinue the quarterly reporting requirements for government initiatives and continue reporting on them annually as a chapter in each revenue requirements application.

The Panel acknowledges the importance of continuing to review reporting on government initiatives on a regular basis as it provides Basic insurance policyholders an opportunity to understand what is included in their Basic rates. However, the Panel is not persuaded there is sufficient justification to continue reporting on a quarterly basis as opposed to annually. ICBC has pointed out that the role of the Commission is to ensure the costs of these initiatives are determined and appropriately included in Basic rates. Moreover, even if the Commission were to disagree with any of the government initiatives it does not have the jurisdiction to direct any changes. Given these circumstances there is limited value in reviewing these initiatives and costs on a quarterly basis. A more appropriate time to review such costs is during the RRA process which is conducted on an annual basis where interveners are directly involved. In the view of the Panel, including such reporting as part of the RRA process will increase transparency and reduce the regulatory burden, and provide an opportunity for comment with no loss of regulatory effectiveness or efficiency.

[29] ICBC Reply, pp. 5-6.