

## Cabinet Decision Document

### MINISTER:

The Honourable Gary Collins, Minister of Finance and Minister Responsible for ICBC

### TITLE:

ICBC's 2003 Autoplan Rate and Product Changes

### ISSUE:       FOR DECISION

- 2001 was one of the worst years ever for the property and casualty insurance industry. Auto insurance rates in Canada increased an average of 15.7% for the period September 2001 to September 2002.
- Despite substantial cuts in administrative costs, with claims costs continuing to rise and investment income continuing to weaken, ICBC will be in a position to lose \$20 million in 2003 and \$60 million in 2004.
- To avoid these losses and to rebuild the Corporation's retained earnings, a rate adjustment is required.
- After six years of rate freeze for both basic and optional coverages, ICBC began to adjust rates last year, with an average increase of 7.4% overall. Last year's submission to Cabinet indicated that ICBC would phase in changes to address historic issues of subsidization and rating inequities in optional coverages resulting from six years of rate freeze. This helps mitigate a large overall rate increase for all policyholders.
- This continued adjustment means that over one million policyholders will actually see their rates drop in 2003 and experienced drivers (ten or more years driving experience) will see improved discounts on optional insurance.
- This issue is relevant to Government's Strategic Plan objective that government will be affordable and fiscally responsible and ICBC's strategic objectives to be fiscally sound by managing claims cost and premium revenues.

### RECOMMENDATION:

- Approve ICBC's recommendation for 2003 Autoplan rate and product changes. The average rate increase for private passenger vehicles would be 1.4% for basic coverage and 7.6% for optional coverage for an overall average increase of 3.9%. For commercial vehicles, the average increase would be 11.9%. These recommendations result in an overall average premium increase of 4.8% (commercial and private passenger vehicles combined). The changes would be effective immediately for new policies and January 1, 2003 for renewals.

### BACKGROUND:

### **ICBC's Basic and Optional Insurance Products**

- All BC motorists are currently required to purchase basic (mandatory) insurance coverage from ICBC to operate their vehicle on the road. The basic insurance product provides BC motorists coverage for injury-related medical and rehabilitation expenses in the event of a crash regardless of who is at fault; and provides third party legal liability coverage where the motorist is at fault and responsible for causing injury or damage to someone else's property.
- The optional insurance product is additional insurance that consumers choose to purchase if they want protection of their assets. Customers have the choice of whether to purchase optional insurance coverage (e.g. Collision, Comprehensive, Specified Perils and Extended Third Party Legal Liability coverage) from ICBC or from private insurers.
- Federal competition practice requires that the basic and optional lines of business be self-sustaining. In other words, the basic insurance business should not subsidize the optional line of business.
- ICBC sets insurance premiums according to an individual's driving and claims record, territory, vehicle use and type of vehicle. It is not based on factors such as age, sex and marital status that a customer cannot control. ICBC's pricing policy is based on the unproclaimed 1979 legislation, which prohibited the BC insurers from determining auto insurance premium levels on such factors.<sup>1</sup>
- Besides some changes that have evolved over the years to respond to increased competition for optional coverage, ICBC continues to follow the spirit of the legislation for pricing both basic and optional insurance. This contrasts with the private sector pricing of optional insurance that is solely based on risk-related factors.
- Private insurers have more flexibility in underwriting and use more selective rating criteria, such as postal code, age and sex to more accurately price risks, than ICBC. Private insurers also choose whom to insure and are not obligated to insure all risk groups or regions of the province. They are therefore able to attract low-risk drivers with lower premiums than ICBC offers, and still realize a positive return.
- With a disproportionate loss of profitable low-risk customers, over time ICBC will be increasingly left with higher-risk policyholders, paying out higher average claims with shrinking premium income. This affects the financial viability of the Corporation and, in turn, the Government's summary account.
- In 2001, ICBC wrote approximately 2.6 million Autoplan policies with just over 1.1 million claims being reported to the Corporation.<sup>2</sup>

### **Current Situation**

- 2001 was one of worst years ever in the property/casualty insurance industry. Companies such as State Farm Canada and Co-operators experienced significant underwriting losses arising primarily from the auto insurance market. Auto insurance rates in Canada increased an average of 15.7%<sup>3</sup> for the period September 2001 to September 2002.
- The table below shows auto insurance rate increases across Canada as reported by Statistics Canada for the year ending September 2002<sup>4</sup>. British Columbia is one of the provinces with the lowest rate increase.

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<sup>1</sup> The legislation, called Automobile Insurance Non-Discrimination Act, was an amendment to the Insurance (Motor Vehicle) Act introduced in 1979.

<sup>2</sup> ICBC, Annual Report 2001, p.6.

<sup>3</sup> See Statistics Canada, "Latest Release from the Consumer Price Index ", September 2002. [www.statcan.ca](http://www.statcan.ca)

<sup>4</sup> See Statistics Canada, "Consumer Price Index Table 326-0001", [www.statcan.ca](http://www.statcan.ca)

**Table 1: Summary of Rate Increases in Canada for the period September 2001 to September 2002**

Province	CAN	NFLD	NS	NB	QUE	ONT	MAN	SASK	ALTA	ICBC*
Rate Increase %	15.7	40.4	48.0	39.3	17.8	10.8	0.7	5.3	36.8	7.4

Source: Statistics Canada, "Consumer Price Index Table 326-0001", [www.statcan.ca](http://www.statcan.ca) \* Source: ICBC

- Auto insurance rates in Ontario increased 10.8% for the year ending September 2002. The Financial Services Commission of Ontario (FSCO) reports<sup>5</sup> the average cost of auto insurance in Ontario was 12% higher at the end of the third quarter 2002 compared to the end of the third quarter last year. Over the last two years FSCO approved average increases of 22%.
- A survey conducted by Runzheimer Canada in March 2002 for Saskatchewan Government Insurance (see Table 2 below) provides a rate comparison across Canada for a driver over 25 years old, driving 2002 Ford Taurus with a clean driving record. The rate for Vancouver is among the lowest across Canada.<sup>6</sup>

**Table 2: Cross Canada Insurance Rates**

Location	Vancov	Calgy	Sask	Winpeg	Tor	Londn	Montr	Que	Moncton	Charl'town	St Jn's
Rate \$ Quoted	1,628	2,048	1,230	1,152	2,995	2,025	3,225	1,969	2,206	1,986	3,292

Source: Collected in March 2002 by Runzheimer Canada for Saskatchewan Government Insurance

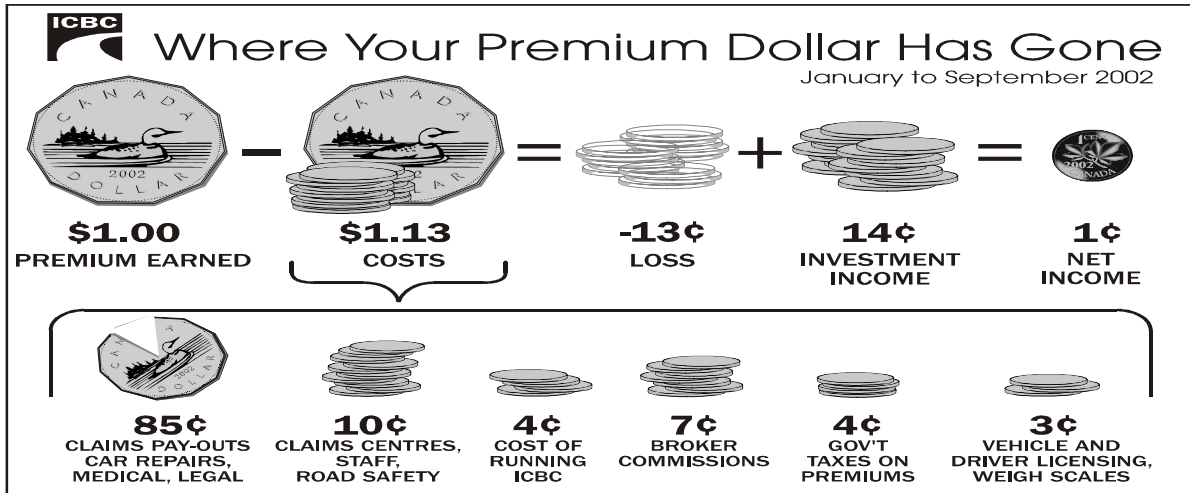
- In the Maritimes the Facility Association for high-risk drivers recently made a request to the Public Utilities Board to approve a rate increase of 61.2% in New Brunswick, 41.3% in Newfoundland and 31.4% in Nova Scotia.<sup>7</sup>
- Profitability in the insurance industry continues to be impacted by rising claims costs, poor investment returns, largely due to a weak economic outlook and weak equity markets. Despite premium increases, many in the industry believe that prices in many market segments are still inadequate. ICBC is in a similar situation.

<sup>5</sup> See Financial Services Commission of Ontario, "Auto Insurance Rates for the Third Quarter", [www.ontarioinsurance.com](http://www.ontarioinsurance.com)

<sup>6</sup> See The Edmonton Journal, "Rush to sue blamed as rates rocket" November 3, 2002. [www.edmontonjournal.com](http://www.edmontonjournal.com)

<sup>7</sup> See Thompson's World Insurance News, "FA wants up to 60% hikes in Atlantic; Pafoc stops new business" Daily News Service, October 23, 2002; "Atlantic auto woes lead to massive FA hikes" [www.thomspensnews.com](http://www.thomspensnews.com) See also CBC News, "High risk car insurer wants higher premiums"; "High-risk drivers could see huge premium increase" [www.cbc.ca](http://www.cbc.ca), November 6, 2002

- For the first nine months of 2002, ICBC costs add up to \$1.13 of every dollar of revenue earned. This 13-cent deficit is only offset this year by ICBC's investment income of 14 cents, resulting in net income of approximately 1 cent on the premium dollar. As the graphic below illustrates, ICBC is currently operating on a slim margin: a one per cent increase in claims costs would wipe out this net income.
- For a company the size of ICBC, a net income of \$24 million is very close to a break-even position.



- **Claims costs are up, with no sign of relief to come.**
  - In the first nine months of 2002, current year claims increased by \$181 million over the same period in 2001. Increased speed, rising costs of injury awards, higher priced vehicles and parts, and auto crime are contributing factors.
  - Individual claims are increasing in average costs per claim, with the average cost of all injury claims up 7.9 per cent, while the average costs of property damage claims is up 4.1 per cent. The number of claims for vehicle theft is up 10 per cent.
- **Investment income is down, with continued weakness expected for 2003.**
  - ICBC's return on its investment portfolio is 6.6 per cent for the first nine months of 2002, compared to an interest rate of about 4 per cent on medium-term government bonds.
  - With low interest rates and continued stock markets volatility, ICBC cannot count on maintaining its current rate of return. Most analysts are predicting lower returns. ICBC will continue its risk-averse investing posture.
  - ICBC is not alone in this situation: all property and casualty insurers are struggling with reduced investment returns.
- **ICBC has reduced its costs substantially, so further savings will be much smaller.**
  - ICBC has reduced its controllable costs by 22 per cent, year to date. Its workforce has been reduced by over 1,300 or 20 per cent from its high in April, 2001.
  - At the same time, ICBC continues its commitment to customer service and has maintained or improved its results in customer satisfaction surveys.

- **Net income is needed to rebuild reserves.**

- ICBC is forecasting a modest net income for 2002, which will be used to help rebuild the Corporation's reserves. The reserve is maintained to protect customers from unexpected losses arising from unusual events or factors.
- Decisions prior to the last election have diminished ICBC's reserves including the \$219 million cost of the pre-election dividend payment, investment in Central City development, resulting in a \$141 million write-down (\$100m in 2001; \$41m in first quarter 2002<sup>8</sup>), and the six year rate freeze.
- ICBC's reserves are significantly below the regulatory requirements for private sector insurers.
- ICBC is forecasting a net income of \$15 million for 2002 compared to a budgeted loss of \$10 million. This modest net income for 2002 will be used to help rebuild the Corporation's reserves, subject to claims and investment income trends.

- **Without changing premiums or products, ICBC is forecasting approximately \$20 million and \$60 million losses in 2003 and 2004 respectively.**

- There is significant uncertainty and risk in these estimates. Assumptions have been made for vehicle growth, inflation, claims trends and investment income returns. A 5% fluctuation in claims costs means a \$115 million change to net income. A 1% change in unpaid claims represents a \$40 million impact on net income. The slower economy, falling interest rates and declining equity markets will result in greater volatility of investment returns. A 0.25% fluctuation in investment return means \$14 million in investment income.
- After six years of rate freeze for both basic and optional coverages, ICBC began to adjust rates last year, with an average increase of 7.4% overall. These adjustments included almost 20% of customers receiving rate reductions based on lower risk. Last year's submission to Cabinet indicated that ICBC would phase in changes to address historic issues of subsidization and rating inequities in optional coverages resulting from six years of rate freeze. This helps mitigate a large overall rate increase for all policyholders.

### **Business Principles**

- ICBC's recommended plan of action is based on the following business principles:

- ICBC operates as a business;
- Basic and optional lines of business are each self-sustaining;
- Raise premiums only after controlling administrative costs;
- Rates for basic insurance reflect inflation and adjustments for increasing claims costs; and
- Rates for optional insurance continue the move towards customers paying a premium according to the risk they represent, as was begun last year.

### **OPTIONS:**

#### **Option 1: No Rate Increase**

- ICBC rates remain the same as last year and no product or policy changes would be undertaken. Rates for the next two years are determined based on the financial situation of the corporation.
- This option is **not recommended**, as it does not meet Government's New Era commitment or ICBC's business principles.

### **Advantages**

- Customers experience no change in premiums from last year.

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<sup>8</sup> \$41 million was received from Tech BC in compensation for the cancellation of the lease.

- High-risk drivers would continue to be sheltered from higher rates through subsidization from low risk drivers.

#### **Disadvantages**

- Forecast loss for ICBC of \$20 million in 2003 and \$60 million in 2004.
- Inconsistent with ICBC's business principles that basic and optional lines of business are each self-sustaining.
- Low risk drivers would continue to pay too much for their insurance and subsidize high-risk drivers.
- Increased loss of the most profitable business to private insurers would potentially increase the net loss for ICBC in 2003 and beyond.
- Required rate increases in 2004 and 2005 would be substantially greater than they would be with some rate change this year.

#### **Option 2: Across-the-Board Rate Increase for all Customers**

- Basic and optional insurance premiums would increase for both private passenger and commercial policyholders by 4.8% for all customers, with no variation according to the risk they represent. Continuation of adjustment of optional rates according to risk and market forces commenced last year would be deferred until 2004.
- This option is **not recommended**, as it does not meet Government's New Era commitment, or ICBC's business principles.

#### **Advantages**

- No confusion, as all customers experience the same increase.
- ICBC would still likely achieve a positive net income in 2003.
- High-risk drivers would continue to be sheltered from higher rates through subsidization by low risk drivers.

#### **Disadvantages**

- Inconsistent with ICBC's business principles as this could result in basic insurance subsidizing the optional line of business.
- Low risk drivers would continue to pay too much for their insurance and subsidize high-risk drivers.
- Increased loss of the most profitable business to private insurers would potentially reduce net income in 2003 and beyond.
- Required rate adjustments in 2004 and 2005 would be substantially greater than they would be under the recommended option.

#### **Option 3: Continue ICBC's Phase-in of Rate Adjustments as commenced last year**

- ICBC's recommended rate and product changes for 2003 would be implemented, as outlined in Appendix A.
- Continues the adjustments initiated last year to address rating inequities resulting from the previous six-year rate freeze.
- Overall average rate increase of 4.8%: 2.0% for basic insurance and 8.9% for optional insurance to have basic and optional lines of business each self-sustaining.
- Premium changes for various other coverages including increased discounts for experienced drivers, increased premiums for garage policies, rental vehicle and equipment policies, and extended third party legal liability to better cover costs. Deductible and other product changes would be made as outlined in Appendix A.
- On a revenue neutral basis, continue to adjust optional premiums depending on the relative risk that customers represent, as commenced last year, capping increases to avoid rate shock.
- Premiums would continue to be priced based on current policy.

This option is **recommended** because it is consistent with ICBC's business principles and continues to address rating issues that evolved during the rate freeze and provides a fair rate of return to ICBC and its shareholders.

### **Advantages**

- Lower rate increase than last year.
- Twice as many customers receiving rate decreases than last year.
- Estimated net incomes of \$40 million in 2003 and \$60 million in 2004.
- Consistent with ICBC's business principles that basic and optional lines of business are self-sustaining.
- Low risk drivers would pay lower premiums with less subsidization of high-risk customers.
- High-risk drivers would still continue to be sheltered from higher rates through subsidization by low risk drivers.
- Required rate increases in 2004 and 2005 would be less than under the status quo option.
- Private insurers will begin to have access to a greater share of the market as ICBC adjusts for rate inequities.
- Reduces rate shock by phasing-in changes.

### **Disadvantages**

- High-risk drivers would experience rate increases to better reflect their risk.
- High-risk commercial vehicles will experience rate increases to better reflect their risk.

### **Significant Implications of Recommended Option:**

- See Appendix B for percentage impacts for all policyholders.

#### *Private Passenger Vehicles:*

- Rates will drop for over 1 million (40%) customers; twice as many as last year.
- Rates will increase for approximately 795,000 (32%) customers by only 0% to 5%; 338,000 (13%) will see an increase of 5% to 10%; and 370,000 (15%) will see an increase of 10% or more.
- Rates for 7,900 customers (.3%) will rise by more than 35% and less than 600 customers will see an increase above 50%.
- Smaller percentage increase overall compared to last year.
- Largest decreases in premiums: experienced drivers of 1980's and early 1990's family vehicles.
- Largest increases in premiums: inexperienced drivers of sports cars and high-end luxury vehicles.
- There may be a loss of low risk customers. ICBC will monitor market share and resulting impacts to the bottom line and may need to consider mid-year adjustments.
- Impacts will vary across geographical area depending on claims history.

#### *Commercial Vehicles:*

- Rate adjustments are a direct reflection of the claims experience in this highly competitive market. (ICBC has approximately 40% of this optional market). Poor performing accounts will see much larger increases.
- Rates will drop for over 80,000 (33%) policyholders.
- Rates will increase for approximately 38,000 (16%) customers by only 0% to 5% per vehicle; 47,000 (19%) will see an increase of 5% to 10% per vehicle; and 80,000 (33%) will see an increase of 10% or more.
- Less than 100 policyholders will see an increase of 50% to 100%.

### **Fiscal Management Considerations**

- ICBC's rates and product changes have a direct fiscal impact on the Corporation's financial viability and therefore government's bottom line.

- The financial impact of ICBC's proposed premium and product changes is approximately \$120 million on a policy year basis (\$60 million in 2003 due to renewals occurring throughout the year).
- Status quo would result in an estimated \$20 million loss in 2003 and \$60 million loss in 2004. Premiums would have to increase substantially more in 2004 and 2005 to make up for this shortfall. In addition, with private insurers continuing to target the most profitable business, ICBC rates would have to increase even more to cover the proportionately higher claims from remaining customers.
- ICBC's proposed strategy for 2003 would move the corporation towards an estimated \$40 million net income in 2003 and \$60 million in 2004 (notwithstanding potential variability due to deteriorating or improving claims trends and investment returns).
- This would begin to rebuild ICBC's retained earnings so that unanticipated claims developments would not result in significant losses to the Corporation or major increases in insurance premiums.
- By continuing to phase-in rate adjustments, as commenced last year, ICBC should be able to avoid significantly greater increases for its customers than would otherwise have to occur to cover claims costs.
- An across the board rate increase would result in approximately the same income for 2003. However, increasing premiums for low-risk customers who are already paying too much relative to the risk represented, would require even greater premium increases in 2004 and 2005. This is inconsistent with the rate adjustments begun last year.

#### **Legislation Required**

- No legislative changes are required. Amendments are required to the *Insurance (Motor Vehicle) Act* Regulation to implement the changes to basic insurance.

#### **Consultations**

- ICBC's rate and product changes are based on business principles and no specific consultation has been carried out with the public.

#### **Communications Strategy**

- These changes and the rationale for them will be communicated to all ICBC customers through regular channels.

#### **Recommended Decision:**

- It is recommended that Cabinet approve ICBC's strategy for 2003 Autoplan rates and product changes, effective immediately for new policies and January 1, 2003 for renewal policies.
  - Premiums:
    - Increase insurance premiums by an average of 4.8% overall (including both private passenger and commercial vehicles), comprising:
      - 2.0% increase on basic insurance
      - 8.9% increase on optional insurance
    - Changes to premiums for various other coverages will also be made including increased discounts for experienced drivers, increased premiums for garage policies, rental vehicle and equipment policies, and extended third party legal liability to better cover costs.
  - Rating Inequities:



- On a revenue neutral basis, continue to adjust optional premiums depending on the relative risk that customers represent, as commenced last year, capping increases to avoid rate shock.
- Deductibles and Other Product Changes (as outlined in Appendix A)
  - ICBC will begin to manually underwrite and increase deductibles for customers with an extensive history of comprehensive or collision claims.

**SIGNATURE:**

Approved by: \_\_\_\_\_  
The Honourable Gary Collins  
Minister Responsible for ICBC

**DATE:**

**KEY CONTACT:**

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**APPENDICES**

**Appendix A** ICBC's Strategy for Autoplan Rate and Product Changes for 2003

**Appendix B** Cumulative Impact of Rate Changes

## **Appendix A**

### **ICBC's Strategy for Autoplan Rates and Product Changes for 2003**

- ICBC's strategy for 2003 Autoplan rates and product changes includes the following:
  - Premiums:
    - Increase insurance premiums by an average of 4.8% overall (including both private passenger and commercial vehicles), comprising:
      - 2.0% increase on basic insurance
      - 8.9% increase on optional insurance
    - Changes to premiums for various other coverages will also be made including increased discounts for experienced drivers, increased premiums for garage policies, rental vehicle and equipment policies, and extended third party legal liability to better cover costs.
  - Rating Inequities:
    - On a revenue neutral basis, continue to adjust optional premiums depending on the relative risk that customers represent (individual's driving and claims record, territory, vehicle use and type of vehicle), capping increases to avoid rate shock.
  - Deductibles and Other Product Changes:
    - ICBC will begin to manually underwrite and increase deductibles for customers with an extensive history of comprehensive or collision claims.

#### Product and Policy Changes

##### *Rate Classes for Ten Years of Driving Experience*

- Experienced drivers, drivers of the vehicle with 10 years or more driving experience, will receive up to an additional 10% experience discount on rates for optional coverages.

##### *Comprehensive & Collision (Own Damage) Underwriting*

- For customers with egregious comprehensive or collision claims, ICBC will begin to manually underwrite and increase deductibles (on renewal).

##### *Garage Policies*

- Garage policy premiums will increase to reflect actuarial pricing. The premium for garage policy coverage will increase by an average of 13.8% for basic, 17.4% for optional and 16.2% overall.

##### *Rental Vehicle & Equipment Policies*

- Rates will increase to reflect actuarial pricing.
- Another amendment will reduce the maximum daily limit for optional Purchased Loss of Use coverage to \$100 per day, with a total limit of \$2000 for most vehicles.

##### *Extended Third Party Legal Liability*

- The overall average rate increase will be 2.1%.

##### *Create New Rate Class for Municipal/Government Vehicles*

- Municipal/government vehicles previously in the artisan rate (trades people) class will be removed from that class and form a new class. The result is an average increase in rates for vehicles remaining in the artisan class and an average decrease for those in the new class due to claims histories.

## Appendix B: Cumulative Impact of Premium Changes: Percentage Impacts for All Policyholders<sup>(1)(2)</sup>

**Table 1: Distribution of Policyholders by Percentage Premium Change (All rate classes, all territories)**

Premium Change (%)	Total number of Policyholders Affected	% of Total Policyholders
35% - 100% Decrease or Greater	200	0
15% - 35% Decrease	5,800	0.2
10% - 15% Decrease	37,000	1.3
5% - 10% Decrease	259,000	9
0% - 5% Decrease	782,000	28
0% - 5% Increase	832,000	30
5% - 10% Increase	385,000	14
10% - 15% Increase	211,000	8
15% - 35% Increase	227,000	8
35% - 100% Increase or Greater	11,900	0.4
<b>Total</b>	<b>2,750,900</b>	<b>100.0</b>

**Table 2: Distribution of Policyholders by Percentage Premium Change (All rate classes, all territories)**

Premium Change (%)	Total number of Policyholders Affected	% of Total Policyholders
Decrease or Increase less than 35%	2,739,600	99.6
Increase 35% or Greater	11,900	0.4
<b>Total</b>	<b>2,751,500</b>	<b>100.0</b>

Notes: (1) Distributions are approximate. Actual distributions at time of implementation may vary slightly.  
 (2) Does not include impacts of changes to specialized products (e.g., garage policies)