Insurance Corporation of British Columbia

Chapter 4

Section II

Controllable Costs

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1 Controllable Costs

Controllable costs are defined within ICBC as all costs (compensation and operating costs) to run the insurance and non-insurance business with the exception of claims payments, broker commissions and premium taxes. It consists of road safety and loss management services, claims services, and insurance and non-insurance operating costs.

ICBC embarked upon aggressive cost cutting measures in 2001 that resulted in a 26% decrease in controllable costs from 2000 to 2002. This has been maintained with very minimal overall increases in 2003. ICBC continues to look for new ways to achieve operational excellence and efficiency. This strategic focus on continual improvement of financial health, and becoming more customer focused and fiscally responsible, is reflected in ICBC's planning and budgeting process.

1.1 ICBC's Planning and Budgeting Process

To accommodate the Commission's regulatory schedule and to provide updated financial information, ICBC is adapting its planning cycle and budgeting process.

The regular budgeting process for ICBC is from July to November. In July ICBC examines early premiums and claims trends for the current year in order to begin assessing the trends for the following year. Throughout September and October, the business areas develop their business plans, which is followed by development of budgets and FTE (full-time equivalent) counts. A modified zero-based budgeting approach towards expenditures was introduced in 2003 resulting in more stringent requirements for consideration of business changes and other discretionary spending. The budgets are entered, consolidated, reviewed and refined through to early November and are submitted to the Board of Directors for final approval by end of November. As a result of this process, the details of the 2005 forecast are not available until November.

Due to this filing, ICBC's high-level budgeting process started in April this year. The first step was to examine early premiums and claims trends for the current year in order to begin assessing the trends for the following year. A detailed outlook was also prepared in May 2004 to gain an understanding of 2004 year to date spending patterns and to provide a better picture of ICBC's financial position for yearend. ICBC also developed high level estimates of the major types of operating costs for 2005. The overall approach for developing the estimate of 2005 controllable costs has been to start with the 2003 actuals and the 2004 outlook, and then to identify any significant anticipated cost changes for 2005.

Based on the above analysis, ICBC determined the controllable cost outlook for the current year and set a target for 2005. This corporate target was shared with the senior management and executives to guide their more detailed divisional planning and budgeting processes and to enable them to better set their divisional targets for 2005. The 2005 targets are realistic and challenging, requiring significant effort on the part of management to find efficiencies and manage costs.

Underlying the forecasting process are fundamental principles, which guide ICBC's budgeting process. These include:

- Increases in costs must be identifiable and justifiable.
- Business changes must be aligned to corporate strategies.
- Continually review business activities for efficiencies and improvements.
- Where appropriate, assumptions used in developing the forecast will be consistent with relevant external sources, such as the provincial government's economic assumption for inflation of 2%.
- Overall staffing levels will continue to be maintained, with internal adjustments made to better meet changing business need. Increases in staffing will be linked to changes in the business environment (e.g. increased claims volumes).
- The vehicle growth assumption, based on relevant economic indicators for 2005, is 1.9%.

- The assumption for Basic insurance expected claims volume is based on actuarial frequency trends. See list of historical and future frequency trends in exhibit B.3 of Chapter 4, Section I.

1.2 ICBC Controllable Costs (Corporate)

ICBC's focus on fiscal restraint kept controllable cost increases to a minimum in 2003. ICBC's cost structure has remained relatively static despite continual cost pressures arising from business improvement changes, technology and system upgrades, facility repairs and maintenance, supplier costs, contractual salary arrangements for employee compensation and general inflationary increases, the majority of which were absorbed during 2003.

Staffing, which had been reduced by approximately 26% from 6,450 to 4,750 over the three-year period 2000-2003, continues to be tightly controlled. Employee compensation accounts for approximately 70% of controllable costs. There is weekly monitoring of staffing changes and monthly monitoring of expenditures of corporate controllable costs. For every position that becomes vacant during the year, there is a stringent review process by senior management before the position is filled. This enables the corporation to shift resources where they are most needed and keep control of staffing levels. Senior management and the Executive also monitor controllable costs on a monthly basis.

Corporately, ICBC will continue to operate like a business and manage costs responsibly.

1.3 Basic Insurance Business Controllable Costs

ICBC operates its Basic insurance, Optional insurance and Non-insurance operations on an integrated basis. Controllable costs for the Basic insurance business are derived from the corporate controllable costs using ICBC's financial allocation methodology (see Chapter 1, Volume 1).

Changes in 2003 Controllable Costs

When comparing actual controllable costs at the end of 2003 to the 2003 outlook, as presented in ICBC's first rate application to the Commission on August 29, 2003, there is a minor increase of $1.3 million in the total of claims services and insurance operating expenses. This represents less than a 1% difference between actual year end results and the outlook.

Within each of these cost categories the differences noted in the table below between 2003 actual and outlook is a change largely due to reclassifications of expenses. Certain expenses are charged centrally and are not assigned to the appropriate cost category until yearend. As a result there are differences between 2003 actual and 2003 outlook by cost category.

Figure 4.II.1
Controllable Costs – Basic Insurance Business Only
2003 Actuals and Outlook
(Dollars in Thousands)

	2003 Actuals	**2003* Outlook**
Claims Services	$148,686	$140,617
Insurance Operating Expenses	68,367	75,140
Total	$217,053	$215,757

*As presented in ICBC's first rate application to the Commission on August 29, 2003

Changes in 2004 Forecast

When comparing the current 2004 outlook, as presented in this filing, to the 2004 forecast presented in ICBC's first rate application to the Commission on August 29, 2003, there is only a small difference consisting primarily of $1.3 million in the total of claims services and insurance operating expenses. Again the forecasting of the 2004 outlook is within 1% of the 2004 forecast.

The reclassifications of costs that occurred at the end of the year for the 2003 actual costs became the new baseline for the 2004 outlook, and accounts for the majority of the changes in each of the categories of costs.

Figure 4.II.2

Controllable Costs – Basic Insurance Business Only
2004 Outlook and Forecast
(Dollars in Thousands)

	2004 Outlook	**2004* Forecast**
Claims Services	$152,832	$143,882
Insurance Operating Expenses	73,032	80,693
Total	$225,864	$224,575

*As presented in ICBC's first rate application to the Commission on August 29, 2003

2005 Forecast

ICBC's controllable costs for operating its Basic insurance and Non-insurance businesses are provided in the table below, with a breakdown of major categories.

Figure 4.II.3

Controllable Costs – Basic Insurance Business Only
2003 Actuals, 2004 Outlook, and 2005 Forecast
(Dollars in Thousands)

	2003 Actuals	**2004 Outlook**	**2005 Forecast**
Road Safety & Loss Management Services	$ 35,478	$ 43,667	$ 45,809
Claims Services	148,686	152,832	155,049
Insurance Operating Expenses	68,367	73,032	76,727
Non-insurance Operating Expenses *	86,516	90,593	89,597
Total	$303,569	$316,457	$321,373

* Commissions related to non-insurance services are reported separately.

Between 2003 and 2005, the more significant cost changes relate to:

- Increased funding to support enhanced traffic law enforcement.
- Increased planned program and system changes expenditures such as the new call centre technology and evergreening of desktop technology.
- The lack of availability of the pension adjustment for the reduction of costs.
- Impact of inflation on operating costs such as building expenses.
- Contractual salary increases including step adjustments.

These changes are discussed in more detail in the sections below.

Road Safety and Loss Management Services

ICBC supports road safety initiatives that provide benefits to ICBC's customers to help keep rates as low as possible. Expenditures for Road Safety and Loss Management in 2004 are estimated to be $43.7 million, which is 23.1% higher than 2003 actual results.

The increase in costs is primarily attributable to increased expenditures on road safety enforcement. In 2003, expenditures on enforcement programs were lower than normal due to delays in program expenditures, while negotiations were underway to adopt a new strategic approach in working with the Ministry of Public Safety and Solicitor General (MPSSG). Funding to support enhanced traffic law enforcement was $8.9 million in 2003 and is expected to increase to approximately $14 million for 2004. ICBC and MPSSG signed a five-year funding agreement effective January 1, 2004 to provide funding to support enhanced traffic law enforcement. The agreement is referenced in the *Special Direction 1C2 to the British Columbia Utilities Commission* as one of the costs that must be taken into account by the Commission (See Appendix 4.III.A, Volume 2). The agreement enables the police to devote additional resources to activities that reduce traffic injuries and deaths caused by impaired driving, aggressive driving and motorists not wearing seat belts. It also provides funding for autocrime prevention programs. The maximum funding under the agreement in calendar year 2004 is $14.6 million, and in calendar year 2005, the amount is $17.0 million.

As a result, overall Road Safety and Loss Management program costs for 2005 are projected to be $45.8 million, which is a 4.9% increase over 2004 outlook.

See Appendix 2A of Chapter 2, Volume 1 for the recent review by external road safety research experts, Ference Weicker & Company Management Consultants, that concludes that overall ICBC employs more comprehensive and rigorous processes for selecting and investing in effective road safety and loss management programs than most other jurisdictions.

Claims Services, Insurance and Non-insurance Operating Expenses

Claims services are the costs of processing claims consisting primarily of staff compensation and benefits, and other general claims operating expenses. These costs relate to major activities within the claims handling process such as reporting of a claim, interviewing the claimant and assessing the claim, rehabilitating the claimant and internal litigation. Claims services are holding the line on expenses.

Insurance operating costs include functions such as underwriting, broker management and administration of the insurance product. Other expenses include corporate shared support services such as finance, human resource management, information systems development and support, planned program and system changes, facilities, and governance and audit functions.

Non-insurance costs include vehicle and driver licensing services, vehicle registration, government debt collection and funding for commercial vehicle compliance. These non-insurance services are outlined and described in the Service Agreement between the MPSSG and ICBC effective September 1, 2003. Included in this agreement is ICBC's payment to government of approximately $25 million annually until March 31, 2006 for the operation of commercial vehicle compliance and motor carrier functions that were returned to government as part of the Core Services Review decision.

Overall, claims services, insurance and non-insurance operating expenses are expected to increase slightly as follows:

The $12.9 million (4.2%) increase in these costs from $303.6 million in 2003 to $316.5 million for 2004 is as a result of claims services costs expected to increase by 2.8% to $152.8 million, insurance operating expenses projected to increase by $4.6 million and non-insurance operating expenses projected to increase by $4 million. These increases are primarily due to:

- Accounting treatment for transitional assets relating to pension plans and the amortization of these assets. ICBC had a net surplus position in its pension plans which was being amortized over a number of years. This had the impact of reducing operating expenses. Since 2003, the pension plans' net surplus position has been declining mainly due to the state of the investment market (as has happened in many other pension plans) therefore the amortization available to offset expenses is lower. This accounts for approximately $4.4 million of cost offsets which are not available for 2005.

- Planned program and system changes expenditures are expected to increase in 2004 by $3.1 million. These changes are considered necessary for sustaining the business and for realizing further improvements. These include the implementation of new call centre technology in claims services that will replace the current legacy systems and other related business process changes required to meet business needs, and upgrades to personal workstation technology affecting all areas of the corporation.

- Increase in resources for supporting regulatory filings and the regulatory process, such as actuarial, accounting and legal services, external professional services, and the BCUC annual charge, totaling approximately $2.6 million in increased operating expenses are mainly impacting insurance operating expenses.

- Contractual salary agreements that result in annual salary increases for certain employees as well as inflationary increases for affected services and operating expenses, other than compensation, also impact all categories of expenses. Increased revenue from fees and interest from premium financing offset some of this increase in expenditures.

- Additional funding for government initiatives, such as veterans plates, which are outlined in the Addendum to the Service Agreement between ICBC and MPSSG.

The $4.9 million (1.6%) increase from $316.5 million in 2004 to $321.4 million in 2005 is as a result of overall claims services cost increase of 1.5% to $155.0 million and insurance operating expenses projected to increase by 5.1% to $76.7 million over the 2004 outlook of $73.0 million. This is primarily due to:

- Further costs of $4.8 million are anticipated in 2005 for changes to the business as a result of the implementation of new requirements stemming from planned program and system changes. These increases will mainly impact insurance and Claims Services operating expenses.

- Contractual salary agreements that result in annual salary increases for certain employees and apply across all categories of expenses.

- Inflationary increases of 2% for affected services and operating expenses, other than compensation, also impact all categories of expenses.

- Increased revenue from fees and interest from premium financing offset some of this increase in expenditures.

- Overall cost increase is also reflective of the expected growth in vehicle policies and anticipated claims volumes.

ICBC will continue to tightly control costs and operate like a business on behalf of its customers. ICBC will continue to look for more effective and efficient ways of conducting its business to keep premiums as low and as stable as possible while providing the service customers expect.