



Executive Summary

ICBC Background

ICBC is a provincial crown corporation established in 1973 to provide automobile insurance to BC motorists. ICBC is the sole provider of universal compulsory automobile insurance (Basic insurance) in the Province. In addition, ICBC competes with other insurance companies in the sale of Optional insurance products. ICBC is one of Canada's largest property and casualty insurers with over \$2.9 billion in premiums written and \$6.8 billion in assets, and employs approximately 4,750 people. ICBC offers insurance products to more than 2.7 million motorists through a network of over 900 brokers and provides claims handling services, processes approximately 930,000 claims per year, through a 24 hour telephone claims handling facility and a province-wide network of 41 locations throughout BC. In addition, ICBC provides vehicle and driver licensing services and vehicle registration services on behalf of the provincial government. ICBC invests in loss management and road safety programs to reduce crashes and automobile crime, which benefit customers by minimizing insurance premiums.

The *Insurance Corporation Act* and the *Insurance (Motor Vehicle) Act* govern the corporation. To improve accountability for rate setting and transparency, the British Columbia Utilities Commission (Commission) became the independent regulator for ICBC during 2003. As a crown corporation, ICBC is also subject to legislation such as the *Budget Transparency and Accountability Act*, the *Financial Information Act*, the *Financial Administration Act*, and the *Freedom of Information and Protection of Privacy Act*. In addition, the corporation has administrative and other duties and obligations under various motor vehicle related acts and regulations.



Current Situation for ICBC

ICBC's key business principles with respect to its insurance business are:

- Run ICBC like a business for the benefit of its customers
- Keep premiums as low and as stable as possible
- Focus on operational excellence to minimize controllable costs and claims incurred costs
- Move to performance-based management

These principles have contributed to ICBC's strong corporate financial performance in 2003. Corporately controllable costs are more than 26% lower than in 2000. Operating expenses compare favourably with other Canadian insurers. The total number of claims decreased in 2003, however the rising auto theft and escalating average cost of injury claims are concerns. As will be demonstrated in this filing, investments in road safety and loss management have contributed to financial success. 2003 results for Basic insurance show premiums earned of approximately \$1.6 billion, underwriting loss of approximately \$89 million, claims incurred and related costs of about \$1.6 billion for an overall net income of \$45 million.¹

ICBC's net income and retained earnings² are used to protect customers and avoid rate shock by allowing ICBC to absorb the unexpected losses arising from unusual events, severe weather, fluctuations in the marketplace and other factors. This in turn also ensures an adequate capital base so ICBC can keep rates stable and as low as possible.

Background to Filing

In 2003 and pursuant to the *Insurance Corporation Act* and the *Utilities Commission Act*, the British Columbia Utilities Commission was established as the independent regulator of ICBC.

¹ All numbers are approximate. See ICBC [Annual Report](#), 2003, page 64.

² ICBC's retained earnings were depleted in 2001 with a \$219 million dividend in addition to a \$251 million net loss. See ICBC [Annual Report](#), 2003.



Under this new regulatory environment, ICBC submitted its first rate application to the Commission on August 29, 2003 and underwent its first regulatory review process with the Commission rendering its decision on November 12, 2003 (the Decision). In the Decision, the Commission directed that in 2004 ICBC address a number of items, including financial allocation. It also accepted ICBC's position of using actuarial methodology for rate setting, which is the industry standard, rather than using an accounting basis.

For 2004 a two stage process for ICBC applications has been adopted. The first application was to be filed by February 27 and the second by July 5.

On February 27, 2004 ICBC made an application to the Commission with respect to performance measures and Basic insurance information sharing. That application was reviewed through a Negotiated Settlement Process. In the Commission's Order G-49-04 (the Order) approving the Negotiated Settlement and its May 20, 2004 transmittal letter, the Commission stated its expectation for additional information on performance measures in ICBC's July 5, 2004 filing. The Commission also alerted ICBC to the need to provide full financial information for 2005 Basic insurance rates.

Purpose of Filing

Application

ICBC is applying for Commission approval of the methodology that ICBC is recommending for the allocation of costs between Basic and Optional insurance.

Additional Information

This first volume of the filing, submitted on July 5th 2004, also provides information on certain matters referenced in the Decision and the Order and associated correspondence. Specifically, this volume contains:

- information respecting the effectiveness and financial evaluation of ICBC's Road Safety and Loss Management Programs; and



- discussion on ICBC's ability to collect and disclose age, sex, and marital status information for Basic insurance rate setting purposes.

ICBC will be filing a second volume of additional information on July 12th 2004. The timing for this second filing results from the need to incorporate changes in response to the new regulation Special Direction IC2 to the British Columbia Utilities Commission anticipated to be deposited in the very near future. The second volume will consist of actuarial and financial information including actuarial rate level indications for Basic insurance in 2005; controllable costs for Basic insurance for 2005; capital requirements for Basic insurance and statistics for and additional information on performance measures. This second volume will have its own executive summary of these sections.

Overview of Application - ICBC's Financial Allocation Methodology

ICBC is applying for Commission approval of the methodology that ICBC is recommending for the allocation of costs between Basic and Optional insurance. In the Decision, the Commission stated, with respect to ICBC's financial allocation methodology, that "the Commission will require further analyses and testing of the individual allocations in next year's proceeding before finalizing the methodology for future years."³

As requested by the Commission, ICBC is providing the further analyses and testing to ensure that the financial allocation methodology used to separate its costs between Basic and Optional insurance lines of business is consistent with generally accepted regulatory principles. ICBC is also responding to the specific issues raised in the Decision with respect to ICBC's financial allocation methodology. ICBC retained John Todd of Elenchus Research Associates (ERA) to assist in conducting a complete review of its financial allocation methodology that was submitted to the Commission as part of ICBC's first revenue requirement application. David Atkins, FCA, Senior Advisor, Corporate Insurance Practice of

³ Decision. page 43.



Lang Michener LLP, has reviewed this report and provided the opinion that both the allocation methodology currently being used, and the recommended changes, are in line with insurance industry practices from accounting and regulatory viewpoints.

ICBC's financial allocation methodology was a cost of service study that determined the costs attributable to each of its three business segments: Basic insurance, Optional insurance and Non-insurance. For shared costs, ICBC used the "pro-rata approach" for purposes of the financial allocation methodology for its 2004 Revenue Requirements Application and in its 2003 Annual Report. An implication of this approach is that costs are assigned between the regulated and unregulated segments of the business using a fully allocated costing approach, and the rates for the company's regulated services are based on the fully allocated costs of the regulated services. This approach also ensures that Basic and Optional services are treated in an equitable manner in that each segment will contribute in an equitable manner to the recovery of fixed and common costs of any integrated operations. For all of these reasons, it can be concluded that ICBC's pro-rata approach is consistent with the generally accepted regulatory principles discussed in the regulatory literature.

As requested by the Decision, ICBC also assesses the alternate allocation methodologies put forward by intervenors during the 2004 revenue requirements hearing.

The detailed analysis approach that is the basis of ICBC's current financial allocation methodology is recognized in the regulatory literature as an appropriate methodology for fully allocating costs to business segments. The literature also recognizes approaches that rely on higher level allocations of costs that do not require a detailed analysis of the regulated company's costs. ICBC is recommending an alternate approach which would be used by ICBC as the basis for determining the costs allocated to Basic insurance in future revenue requirement applications. The preferred approach should reduce the regulatory lag, reduce the complexity, and rely upon allocators that are calculated from accounting information. The recommended approach relies on the key financial drivers of the corporation, e.g. premiums written and claims incurred, both of

which are actuarially determined. Adoption of this methodology would result in reductions in the costs allocated to Basic insurance in 2003 and 2004 and would shift costs in excess of \$6 million from Basic to Optional insurance in 2005 as compared to the detailed analysis approach that is currently being used by ICBC. The recommended approach is therefore not only a fully allocated costing, or pro-rata, methodology that is consistent with generally accepted regulatory principles, and it is an approach that produces an equitable allocation of costs in a simple, transparent and logical way.

Overview of Additional Information

The following is a summary of the additional information provided in volume one of this filing.

Road Safety Program Evaluation

Further to the Decision and the Order, in this filing ICBC provides additional information on ICBC's process to determine the effectiveness of its Road Safety and Loss Management programs, including the criteria for investment and evaluation processes. ICBC also provides financial evaluations of Road Safety programs, including benefit/cost analyses. A recent review (which is included in this filing) by external road safety research experts, Ference Weicker & Company Management Consultants, 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. The review states that ICBC is a leader in evaluating road safety and loss management programs and that ICBC also conducts more evaluations and devotes significantly more resources to conducting evaluations of its programs than most other jurisdictions.

Data Collection of Age, Sex, Marital Status

In recent Commission correspondence, the Commission noted ICBC's position that "both applicable principles of law and a government direction prohibit ICBC from gathering insurance statistics on the basis of age, sex and marital status.



The Commission directs ICBC to further address this issue in its upcoming application so that the Commission can provide some direction to the corporation prior to it initiating work on a Rate Design Application.”

In this filing ICBC provides its analysis of the *Freedom of Information and Protection of Privacy Act*, the Special Direction IC1 to the British Columbia Utilities Commission, and the 1992 Supreme Court of Canada’s decision in *Zurich Insurance Co. v Ontario (Human Rights Comm.)*, in support of its position on collection and disclosure of age, sex and marital status information.

Conclusion

ICBC looks forward to working with the Commission and intervenors in their review of the information presented by ICBC, including the approval of the recommended financial allocation methodology.