

Cabinet Decision Document

MINISTER:

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

TITLE:

Core Services Review Outcomes—Insurance Corporation of British Columbia (ICBC)

ISSUE: FOR DECISION

Seeking approval for Core Service Review outcomes for ICBC.

RECOMMENDATION:

That Cabinet approve the following:

- Transfer ICBC’s Commercial Vehicle Compliance and Motor Carrier functions to government;
- Move ICBC under the authority of an independent, arm’s-length regulatory body; and
- Within the scope of its remaining responsibilities, focus ICBC’s priorities on “right-pricing” its insurance products and “right-sizing” its operations, as the Corporation transitions into a more competitive environment.

BACKGROUND:

Mandate and scope of the review

Government directed ICBC's Board of Directors to carry out a review of ICBC and BC's auto insurance system, in keeping with government's new era commitment to:

- Introduce greater competition in auto insurance to create increased choice and reduce motor vehicle premiums.

Government also provided direction to:

- Recommend the right thing to do for the people of BC.
- Provide the governance to run ICBC efficiently.

The Board considered Government's Core Review tests (as laid out in the Premier's July 31, 2001 letter to Ministers):

- Public interest
- Affordability
- Effectiveness
- Efficiency
- Accountability

Relevant Government principles and priorities (relevant to ICBC) considered:

- Ensure sound fiscal management; balance budget by 2004-05.
- Vision of safer streets in every community.
- Enhance competitive business climate.
- Principle of user pay.

Finally, the Board adopted the following additional guidelines (in consultation with government):

- Do what is best for the customer.
- Optimize economic value of ICBC to Province.
- Minimize uninsured drivers on BC's roads.
- Reduce risk and severity of injuries.

Components of the Review

The review was conducted in three components:

- Review of ICBC's external environment, including current factors affecting the property and casualty insurance industry in Canada and elsewhere;
- Comprehensive, in-depth review of ICBC's current operations;
- Explore full range of alternatives for ICBC and BC's auto insurance system.

ICBC’s current structure and operations

For a summary of ICBC’s current structure and operations, see Appendix A.

REVIEW RESULTS

External environment review, including property and casualty industry

Any review of ICBC would be incomplete without a careful consideration of the broader environment in which it operates, including conditions impacting the property and casualty insurance industry in general.

- **Insurance industry in trouble: rising costs, rising premiums, poor profitability**
 - The industry is facing rising claims costs, falling investment income and poor profitability.
 - In this environment, the industry has entered a phase of “market hardening”, in which insurers return to sound underwriting fundamentals and “right-pricing,” rather than relying on investment returns to compensate for rate inadequacies while competing for market share.
 - These factors have forced double-digit premium increases or many insurers have simply pulled out of certain markets.
 - In October 2002, the Canadian Association of Direct Response Insurers, in a submission to the Ontario government’s auto insurance review committee, described the current market situation as “a crisis of unprecedented magnitude.”
- Summary of auto insurance rate increases elsewhere in Canada:

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

* Source: ICBC

- The current state of the industry has created an environment in which rapid change in the BC market, especially a sudden move to full competition, could have a destabilising effect, with a significant potential for:
 - uncertainty and chaos for consumers, including sudden rate changes or unavailability of insurance;
 - substantial fiscal risk to the government.
- **Playing field is not level**
 - The playing field for ICBC and private insurers is not level for competitive insurance products, but contrary to common perception, this is not always to ICBC’s advantage.
 - ICBC’s monopoly on basic insurance does give it an advantage in the optional market, by guaranteeing access to all customers and through the “convenience” factor of one-stop shopping for licensing and insurance needs.

- However, private insurers have the advantage of not being required to insure everybody. They avoid:
 - high risk customers
 - high risk geographical locations
- Private insurers have the ability to base all premiums entirely on risk.
- ICBC does not base premiums on age, gender or marital status.
- Private insurers are also able to “bundle” auto insurance with other lines of business, such as home and life coverage, offering price and convenience advantages to their customers.

Review of ICBC’s current operations: challenges and opportunities

Challenges

1. ICBC’s Commercial Vehicle Compliance and Motor carrier operations are a poor fit with the Corporation’s core insurance mandate

- Commercial Vehicle Compliance is primarily a law enforcement function. From a public policy perspective, it is a much better fit with government’s law enforcement, security, and inter-provincial and international trade responsibilities.
- The Motor Carrier Department supports the work of the Motor Carrier Commission, which reports to the Minister of Transportation. In terms of administrative efficiency, it makes sense for the Department to move to the Ministry of Transportation.

2. ICBC operates under a regulatory framework which hinders increased competition and confuses ICBC’s roles in achieving public policy objectives versus business objectives and customer needs

- Although the B.C. optional auto insurance market has been open to competition since 1976, private sector participation in this market remains limited in 2002 despite a slow and steady rise since the mid-1990s. ICBC remains the dominant player in the optional insurance market.
- ICBC has a number of inherent advantages that contribute to its dominant position. Private insurers have other advantages that have supported them in making a small initial entry into the B.C. optional auto insurance market.
- However, both the private insurers and ICBC are competing under different rules, which is inhibiting the creation of a competitive market for optional auto insurance.
- ICBC has three distinct obligations:
 - to provide mandatory insurance and public services;
 - to provide competitive optional products and services;
 - to comply with Government regulatory requirements for motor vehicle and driver licensing and registration.
- As a result, ICBC’s competitive and mandated operations are often tightly co-mingled, as are its public policy and business mandates. There is a need to clarify when ICBC is working to achieve public policy and when it is working to achieve business objectives and consumer needs. Actions to achieve this clarity will require time for implementation.

- In addition to improving competition, Government's decisions regarding rate and product changes can be perceived to be politically motivated and not based on sound business decisions.
- These perceptions are due, in part, to the lack of transparency surrounding Government and ICBC decisions.
- In order to increase competition and to improve the transparency regarding ICBC-related decisions, the following issues need to be resolved:
 - What changes to the relationship between the Government and ICBC are required to achieve greater competition while minimizing the financial risk to the customer?
 - Given the answer to the question above, what changes are required to how auto insurers are regulated?

3. Rising claims costs, low reserves

- ICBC is experiencing rising claims costs (up \$181 million in the first nine months of 2002), as is the case elsewhere in Canada in the property and casualty insurance industry.
- Crashes are increasing in frequency and severity, while autocrime is on the rise.
 - Average cost of bodily injury claims up 7.9 per cent; property damage claims up 4.1 per cent.
 - Number of claims for vehicle thefts up 10 per cent.
- Despite ongoing cost controls, increased premiums will be required to offset claims costs in order to maintain financial stability, as operating at a loss is not an option.
- In addition, ICBC needs to rebuild its reserves. The reserve is maintained to protect customers from unexpected losses arising from unusual events or factors.
- Politically driven decisions prior to the last election have diminished ICBC's reserves.
 - \$219 million cost of pre-election dividend payment.
 - Investment in Central City development, resulting in a \$141 million write-down (\$100m in 2001; \$41 m in first quarter 2002).
 - Six-year rate freeze.
- ICBC's reserves are significantly below the regulatory requirements for private sector insurers.

4. Information systems need upgrading

- ICBC's information systems, which are central to ICBC's competitiveness, are outdated.
- Work is now underway to replace them with more flexible, modern systems necessary to be competitive in the future.

5. Further opportunities to cut costs, despite savings to date

- While further savings can and will be achieved beyond the 22% reduction year-to-date, they will be much smaller, as the major gains have already been made.
- At the same time, ICBC continues its commitment to customer service and has maintained or improved its results in customer satisfaction surveys.

Opportunities

1. **The integration of driver licensing and vehicle licensing and registration activities, as well as road safety programs, have had significant public policy benefits**
 - Cost savings due to economies of scale.
 - Helps ensure BC's extremely low rate of uninsured drivers.
 - ICBC's core insurance mandate drives the performance measures for road safety and licensing activities. Only activities that deliver bottom-line savings in terms of reduced frequency and severity of crashes, injuries and fatalities are undertaken.

2. **Product and service delivery system generally efficient**
 - Network of independent brokers throughout the province is efficient and functions well.
 - Linkage of basic insurance to vehicle registration ensures BC's enviable record of minimal uninsured motorists on the road.

3. **Major asset in ICBC database**
 - ICBC's database, which has been created and maintained at considerable cost, represents an opportunity to capture significant benefits for ICBC's customers and the people of BC.
 - The database has the potential to be used to:
 - develop products that offer greater consumer choice and are better tailored to meet individual customers' needs;
 - inform the development and continuous improvement of road safety programs.

4. **Leading edge research delivers benefits**
 - ICBC has successfully partnered with the private sector in loss management research to reduce crash frequency and/or cost. Examples include:
 - **Head Restraint Measuring Device** designed by ICBC, has had over 60 sales worldwide to auto manufacturers and auto seat manufacturers as a whiplash prevention tool.
 - In partnership with a BC engineering firm, ICBC has developed and patented a **road friction sensor**. Data from the sensor will feed real-time road condition information to drivers via roadside displays, as well as to maintenance crews through mobile data transmission.
 - A **wildlife protection system**, designed to avoid collisions with wildlife, has been developed using a NASA-designed infrared camera. Patents have been filed and ICBC has partnered with a Canadian company to market the system.
 - ICBC has partnered with other agencies and communities to improve 1000 high crash locations since 1995.

5. **School-based youth education programs**
 - Focus has been on road/vehicle awareness and seatbelt usage for the younger students, and drinking and driving for older students. Examples include:
 - *RoadSense Career and Personal Planning (CAPP)*: curricular program for BC high schools to provide information on the risks associated with youth passengers and drivers to students in grades 8 to 12.

- ICBC partners with brokers to educate youth through a series of community oriented road safety programs:
 - *Extreme. Not Stupid:* a multimedia, DVD that explores the issues of risk management for youth.
 - *Youth CounterAttack and RoadSense Society of BC (C.A.R.S. BC)* is a network of students and adult advisors across BC working together to help prevent car crashes.
 - *Road Sensibility* is a classroom-based program of field trips, speakers and case studies designed for young people who have not yet reached driving age.

Recent Changes in ICBC

The current government appointed a new Board of Directors in June 2001. The new Board has overseen a number of crucial shifts in the way ICBC is run.

- **22 per cent reduction in controllable costs**
 - Reduction achieved in first nine months of 2002, as compared to the same period in 2001.
 - 1,300 (20 per cent) fewer employees since Spring, 2001.
 - leased office space reduced by 130,000 square feet (19 per cent reduction in leased space).
 - begun claims centre rationalization (three centres closed in Victoria and Lower Mainland), with move to all providing full service and possible extended hours.
 - begun a review of its Material Damage supplier programs to focus more on safety and quality aspects associated with vehicle repair.
- **Increased focus on customer service**
 - At the same time as reducing costs, ICBC has maintained or improved the results of its customer satisfaction scores.
 - ICBC has undertaken ongoing customer focus groups to better understand what customers value, and to translate that knowledge into more valued products and services, as well as better customer service.
- **Change in corporate culture**
 - Have commenced change in corporate culture from one of entitlement to accountability and performance.
 - Performance based remuneration plans in place for Executive; expansion to cover all non-union staff as of January 1, 2003.
- **Ongoing rate adjustment**
 - Continue to review and adjust premiums to address rating inequities resulting from the six year rate freeze.
 - Have begun to depoliticize rate setting by removing the rate freeze imposed six years ago.
- **Put in place clear and appropriate guidelines around the investment of ICBC's reserves**
 - Wrote down ICBC's investment in Central City development in Surrey to better reflect the value of those assets.

- Management of ICBC's equities portfolio outsourced to private money managers; performance indexed to S&P/TSX.

OPTIONS:

Given the current state of the insurance industry, the challenges associated with implementing alternatives for BC's auto insurance system are particularly acute. Introducing a significant immediate change to the market structure at this point could have a destabilising effect that would likely result in sudden rate increases for many drivers.

Specifically, the options that were considered but not recommended to proceed at this time include:

- **Status Quo** – retain its monopoly on basic insurance and continue to compete on optional insurance. ICBC would not move to right pricing premiums as is the standard practice by private industry and would continue to pay for and deliver the compliance function.

This option does not take any step toward meeting the New Era commitment to increasing competition in the auto insurance industry.

- **Competitive Subsidiary** – retain the monopoly on basic insurance with organizational separation of optional insurance within ICBC. The optional business would be under the same regulatory structure as private insurers.

This option requires the subsidiary to immediately raise sufficient capital to meet regulatory requirements to protect against insolvency and catastrophic events. It also involves significant transitional costs and a loss of economies of scale. The current market would make it difficult to raise the necessary revenue for the additional capital and expenses without significant premium increases.

- **Full Competition** – ICBC would remain a crown corporation but the monopoly would be completely dissolved and all insurers would compete for both basic and optional coverage.

Under this scenario, ICBC would have to move immediately to full risk-based pricing for both basic and optional insurance products, creating significant rate shock for a number of customers. As with private sector practise, ICBC would begin to refuse insurance to high-risk customers, leaving a number of drivers unable to acquire insurance. This would necessitate the creation of a facility to handle high-risk customers (shared among all insurers). Otherwise, if left with ICBC, the high claims pay-outs associated with these risks would create significant financial burden for ICBC's policyholders and the provincial government.

Like with the competitive subsidiary option above, this option would require an immediate injection of capital. Rates would have to increase accordingly. ICBC's value would deteriorate and would eventually result in financial insolvency and a negative impact to the government's bottom line.

- **Privatize the Material Damage part of ICBC** – Under this option, ICBC would maintain a monopoly on the bodily injury business, both contractual benefits and third-party liability but the whole material damage business would be sold off. Government retaining a role in the bodily injury insurance business is consistent with its role in social policy and health care.

However, it would be unlikely that a private sector buyer would be willing to pay the full value that a monopoly on the material damage business would warrant given the current industry environment.

There would also be a need for private insurers to raise the necessary capital and recover acquisition and start-up costs, which would likely lead to increased rates.

- **Privatize all of ICBC** – the whole of ICBC operations could be sold off to the private sector either through the sale of corporate assets or shares through an initial public offering. Government's only involvement in automobile insurance would be regulating market conduct.

The same issues apply related to the likelihood of a buyer willing to pay for the full value of a monopoly, the immediate need for capital and the need to recover acquisition and start-up costs.

Recommended Option: Approve the following Core Services Review reforms:

- Transfer Commercial Vehicle Compliance and Motor Carrier functions to government;
- Move ICBC under the authority of an independent, arm's-length regulatory body; and
- Within the scope of its competitive remaining responsibilities, focus ICBC's priorities on "right-pricing" its competitive insurance products and "right-sizing" its operations, as the Corporation transitions into a more competitive environment.

Advantages:

- Transfers to government activities that:
 - are inconsistent with ICBC's central role as an insurer;
 - reside more appropriately in government due to their strong public policy underpinnings and connection to issues of interprovincial and international trade.
- Moving ICBC under an independent, arms-length regulatory body will:
 - Increase the efficiency and flexibility of ICBC's operations.
 - Transition ICBC to more closely resemble a private sector corporation.
 - Ensure ICBC's compliance with rate, solvency, investment and consumer protection regulations.
 - Increase competition in the optional insurance market by allowing for the creation of a level playing field (ensuring no subsidy between mandatory and optional insurance).
 - Provide flexibility for "right-pricing" optional products in a more competitive environment.
 - Ensure continued public policy guidance as appropriate.
 - Take ICBC's insurance product, rates, investments and reserving policy out of the arena of political decision making.
 - Allow continued results-based funding for road safety and other initiatives that reduce claims costs.

- Provide flexibility for any further changes to be contemplated for ICBC in the future.
- Provides an opportunity to:
 - Maximize the value of ICBC to its shareholder, the people of B.C.
 - Continue exploring alternative solutions to produce greater efficiency, superior customer service and low rates.
- Ensures that:
 - ICBC continues to provide affordable and accessible mandatory auto insurance to British Columbians.
 - Financial risk to customers is minimized and the financial value of ICBC is maintained.

Evaluation of recommended option:

This option is recommended because it:

- Avoids the risks posed by a quicker shift to increased competition, given the current industry environment:
 - Avoid sudden, drastic premium increases for many customers.
 - Avoid financial risk to government of major losses by ICBC.
 - Avoid risk of increased number of uninsured drivers.
- Begins a process of transition to increased competition.
- Takes into account the current adverse conditions faced by the property and casualty insurance industry by taking an evolutionary, rather than revolutionary approach.
- Avoids sudden, large premium increases in BC for certain groups of customers.
- Provides ICBC with appropriate stimulus to move to “right-sizing” and pursue further efficiencies that will benefit its customers.
- Will help maximize ICBC’s value to the people of B.C.
- Provides maximum flexibility to implement further changes in the future.

SIGNIFICANT IMPLICATIONS:

FISCAL MANAGEMENT CONSIDERATIONS:

Impacts of transfer of Commercial Vehicle Compliance and Motor Carrier functions will have to be considered. The annual cost of these activities is approximately \$22 million. Revenues from these activities are approximately \$12 million annually, which are already remitted to government on a gross basis.

Continued cost controls and premium adjustments will help ensure an ongoing positive impact on ICBC’s financial position, maximizing its value to its shareholder, as well as maintaining its stability as a reliable insurer.

LEGISLATIVE CONSIDERATIONS

The transfer of Commercial Vehicle Compliance and Motor Carrier functions will require legislative changes. These are expected to be ready for the Spring 2003 session of the Legislature.

Moving ICBC under the authority of an independent regulatory body will also require legislative changes. A detailed policy framework will be required for this shift, prior to drafting legislative amendments, which are targeted for Spring 2003.

CONSULTATIONS

Public Consultation

- ICBC’s Core Services Review was widely known throughout affected stakeholder groups and the general public.
 - There was an open invitation for input from all stakeholders and the general public.
 - ICBC’s Board received input from many stakeholders and outside experts.
 - All input was considered as part the review.

Inter-Ministry, Inter-Agency and Inter-governmental Consultation

- The Ministry of Public Safety and Solicitor General and the Ministry of Transportation have been consulted in regard to the transfer of the Commercial Vehicle Compliance and Motor Carrier functions. These consultations will continue during implementation.

While the immediate impacts on the majority of ICBC’s customers and business partners will be minimal, ICBC will need to establish an ongoing communications program to clearly communicate progress and impacts as these reforms are implemented.

RECOMMENDED DECISION:

Approve the Core Services Review reforms for the Insurance Corporation of British Columbia.

SIGNATURE:

Gary Collins
Minister of Finance

Date

KEY CONTACT:

Nick Geer
Chair, ICBC Board of Directors

Appendix A: Summary of ICBC's pre-core review operations

ICBC is a provincial Crown corporation established to provide universal auto insurance to B.C. motorists. In addition, ICBC is responsible for road safety initiatives, driver licensing, vehicle registration and licensing, commercial vehicle compliance and motor carrier administration.

ICBC's operations generate over \$2.6 billion in annual insurance premiums from more than 2.7 million motorists, as well as \$420 million in license fees and fines. ICBC uses a network of over 900 independent brokers to provide one-stop shopping for ICBC's insurance products, vehicle registration and licensing services. The linkage between vehicle licensing and auto insurance also serves to minimize the number of uninsured motorists in B.C.

All motorists in B.C. are required to buy a basic package of ICBC Autoplan insurance that provides coverage for third party legal liability, accident benefits, underinsured motorist protection, hit-and-run and uninsured motorists protection and inverse liability.

The total of these coverages provides B.C. drivers with one of the best benefit packages in Canada.

In addition to providing this basic insurance, the Corporation competes with other automobile insurance companies in the sale of extended third-party legal liability and other optional insurance coverages such as collision and comprehensive coverage.

As a result of the merger with the Motor Vehicle Branch in the late 1990's, ICBC provides driver licensing services, commercial vehicle compliance (e.g. weigh scales and commercial vehicle inspections) and expanded road safety programs. On an annual basis, ICBC performs over 1.2 million transactions relating to the issuance of driver licences and driver exams. Since 1997, ICBC has invested between \$30 to \$60 million annually on road safety programs.

Investments are made in loss-prevention initiatives, which result in financial benefits to ICBC's policyholders from reduced crashes, injuries and deaths. Examples of these programs include: Graduated Licensing, Intersection Safety Cameras, cost-sharing partnerships with provincial and municipal authorities for road improvement projects and funding for enhanced enforcement for speeding, dangerous driving and CounterAttack campaigns.