

GOVERNMENT FLOATS POSSIBLE CHANGES TO RATE DESIGN FOR ICBC BASIC INSURANCE

On 5 March 2018 minister responsible David Eby launched a public consultation on making the pricing ICBC's Basic insurance product fairer. The government news release clearly implied that the current rate structure is unfair and was seeking "public engagement" to improve the determination of risk in establishing prices.¹

"Drivers have been saying for years that the system would be more fair if low-risk drivers paid less for their vehicle insurance, while high-risk drivers paid more," said Attorney General David Eby. "This engagement is one way government is giving drivers the power to shape ICBC and restore public confidence in our public insurer."²

The government also released several proposals designed to better a line individual risk when establishing the premium price.

This paper will review the underlying assumptions of the initiatives.

Public Questionnaire Without Context

The online questionnaire will provide a snap-shot of uninformed opinions and beliefs. One would expect that most respondents will support changes which appear to make the system fairer (especially if they expect lower rates), but the responses would have been much more useful had ICBC provided data on the value of the current discounts and surcharges, and the number of drivers paying financial penalties related to accumulated driving points and other traffic violations.

Currently Bad Drivers Do Pay More

Currently, high-risk drivers do pay more than low-risk drivers, but this aspect of the current rate design is down-played in the March 5th announcement. The real question is whether the current incentives to encourage low-risk driving behaviors are achieving the objectives of reduced crashes and injuries.

Unfortunately, ICBC does not regularly report on the number of policyholders who are receiving premium discounts or surcharges, nor the foregone revenue or the surcharge revenue generated by the current system.³

Rate Design Complex – Requires Principles

Neither ICBC nor the government released any insurance pricing principles or background papers explaining the current model, to educate the public. While the online

¹ <https://news.gov.bc.ca/releases/2018AG0006-000324>

² Ibid.

³ Some 80% of Basic policyholders qualify for the 43% premium discount, but ICBC does not report on the foregone revenue or the surcharge revenue related to the Claim Rated Scale. ICBC does not report on the foregone premium income resulting from the government directive to provide seniors with a 25% discount and the discount for handicapped drivers.

questionnaire appears to promote a more driver-based pricing model, little or no financial comparisons of the status quo and other options were provided.

As ICBC informed the BC Utilities Commission in 2007 “automobile insurance rate design, particularly in the context of ICBC’s Basic insurance, is very complex.”⁴

In developing the current pricing model ICBC adopted several principles. The price should be fair, just and reasonable; it should promote rate stability and predictability; and it should be simple to administer and relatively easy to understand.

In its 2007 discussion of pricing risk ICBC noted that the ideal for an insurance company is to determine an accurate rate (or premium) for each customer. “Accomplishing this would mean accurately pricing each customer according to his or her own risk characteristics. Because that is not practical ... it is insurance industry practice to select rating variables based on statistical, operational, social and legal criteria. The process generally involves trade-offs....”⁵

A significant trade-off is the government requirement that age, and sex cannot be a risk criterion,⁶ and that senior and handicapped drivers receive a 25% discount. These requirements are not part of the normal actuarial determination of rates and force ICBC to develop alternatives, or work-arounds, to develop more accurate risk-adjusted rates.

Hence the focus on driver (as distinct from policyholder) risk as demonstrated by traffic violation convictions (in addition to causing crashes).

The Current Model

The current private vehicle premium model attempts to price risk by assessing the value of the vehicle, the geographic territory, and the experience of the owner/principal operator (the driver). The experience of the driver is assessed based primarily on years without an at-fault claim.

In addition, drivers with traffic violation convictions registered against their driver license must pay a financial penalty separate from the insurance premium.

To Ensure that Higher-Risk Insured Pay More ICBC Will Alter the System to Classify More Insured as High-Risk

A premium discount/surcharge system –the Claim Rated Scale (CRS)—rewards policyholders by reducing the “average” premium by 5% for each year of no at-fault claims to a maximum of 43%. Policyholders whose vehicle is involved in an at-fault

⁴ http://www.bcuc.com/Documents/Proceedings/2007/DOC_14727_B-1-1_ICBC-Rate_Dsgn_App-Vol1.pdf p. 16.1-21

⁵ Ibid., p 16.1-20.

⁶ The Insurance Bureau of Canada claims that a private sector-based insurance delivery system in BC would result in lower rates for most policyholders. However, the IBC approach assumes that the public policy restrictions on the rate design would be eliminated. <https://www.insurancebusinessmag.com/ca/news/breaking-news/report-bc-drivers-could-save-through-open-auto-insurance-market-93823.aspx>

claim (ICBC's insurance is tied to the vehicle) would see a surcharge of 10% for each at-fault claim.

ICBC does not publish the number of policyholders receiving the discount or paying the surcharge, and foregone revenue because of the discount, nor the net impact on premium revenue. Approximately 80% of Basic policyholders qualify for the full 43% discount.⁷ ICBC states that each year 40% of policyholders who cause a claim to avoid paying a higher premium because they have earned the maximum safe-driver discount.⁸

Apparently, the current model is too generous as ICBC has proposed a tightening of the incentives in the CRS to reduce the proportion of policyholders qualifying for the full discount. Some of these changes were previously announced on 3 March 2017.⁹

Further Targeting Drivers

The currenting system insures policyholders with the premium calculated on the risk profile of the policyholder or the principal operator. ICBC is proposing to institute procedures to better target the risk posed by drivers who are not the principal operator, on the assumption that such drivers pose a higher risk of causing crashes.

There are currently three programs which financially penalize drivers who incur traffic-related convictions:¹⁰

- The Driver Penalty Premium (DPP) program is linked to the driver's license and results in escalating financial penalties depending on the points incurred in a 12-month assessment period.
- The Driver Risk Premium (DRP) program targets more serious offenses over a three-year period and includes higher financial penalties.
- The Multiple Crash Program imposes a \$1,000 penalty where the driver is at least 50% responsible for three crashes in a three-year period.

These financial penalties are paid to ICBC by drivers and are separate from the insurance premium. Traffic convictions are an indicator of higher-risk driving behavior which, in turn, increases the probability of causing a crash.

In 2016/17, ICBC received approximately \$26 million in revenue from drivers, compared to \$6.0 billion in premium revenue linked to vehicles.¹¹ Clearly, the CRS has a much greater impact on the corporation's revenue than the two driver-based programs.

⁷ Information from FOIP response TRA-2016-64926, p. 5 of 14.

⁸ <http://vancouver.sun.com/news/politics/province-proposes-major-changes-to-icbc-rate-structure>

⁹ See

http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_24_revised_5_march_2017/pdf/occasional_paper_no_24_revised_5_march_2017.pdf

¹⁰ <http://www.icbc.com/autoplan/costs/Pages/Claims-and-your-insurance-costs.aspx>

¹¹ <http://www.icbc.com/about-icbc/company-info/Documents/ar-2017.pdf>, premiums earned, p. 37.

ICBC wants to significantly increase the financial penalties of the DPP and the DRP programs, apparently to mirror the increase in the average Basic premiums (which increased by approximately 45% during the last seven years).

To demonstrate that the DPP and the DRP programs result in safer driving ICBC should produce an analysis of the effectiveness of these programs, otherwise the proposed increases will be seen as a cash-grab.

The proposal to list all potential drivers of the insured vehicle (and penalize the owner if an unlisted driver causes an accident) appears to be part of a broader strategy to increase premium revenue by targeting risk to drivers who are neither the policyholder or the principal operator. ICBC claims that 20% of drivers in a crash are driving a car that is not their own.¹² The implication is that these are higher-risk drivers, but they may be the declared principal operator and they may not be deemed liable.

Seniors' Discount

Government has directed ICBC to provide policyholders aged 65 and older (who insure for pleasure use) a 25% discount on the Basic insurance. Presumably this is in recognition of lower income.¹³ ICBC is proposing that the discount be reduced or eliminated if the senior is responsible for one or more crashes.

Treating the discount as a privilege earned by safe driving is completely contrary to its purpose, which recognizes a lower income level.

SUMMARY

Some of ICBC's proposals to promote greater fairness in rate design are sensible and can be accomplished with few adjustments to the current processes. ICBC's attempt to fine-tune the determination of risk between the owner/principal operator and the actual driver would seem to entail a large amount of system re-design and a major increase in administrative procedure. One must seriously question the cost/benefit calculation that supports these proposals.¹⁴

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¹² <http://vancouversun.com/news/politics/province-proposes-major-changes-to-icbc-rate-structure>

¹³ I have argued that the government, not Basic policyholders, should pay for this policy which costs about \$100 million annually.

¹⁴ Perhaps ICBC should instead concentrate on adapting the rate design to permit family packages, and the option to insure multiple vehicles within a single policy.