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REDESIGNING ICBC'S INSURANCE RATES: POPULARISM OR EMPIRICAL EVIDENCE?

We are told by the government that that the current Basic insurance rate design is unfair, as lower-risk drivers are paying more than they should and higher-risk drivers are paying less. On this premise the government presented a wide variety of proposals to redesign ICBC's Basic rates to enhance fairness. Many of these proposals were floated during the 2007 review of the design of Basic rates and have been dusted-off for the current "public engagement" exercise.

A public consultation can produce useful advice and suggestions, but only if there is sufficient research and documentation to inform the public.

Unfortunately, the current process seems akin to the consultation provided when the Earth was about to be demolished by the Vogons, as described by Douglas Adams in his classic *Hitchhiker's Guide to the Galaxy*; the relevant consultation material was available only four light-years away!

In the case of ICBC rate design fairness, ICBC has not provided any data or analysis to justify the claim that the current rate design is unfair, or that the proposed changes will result in a fairer distribution of premium and other revenue.

This paper provides some comments about the government/ICBC's suggested changes.[1]

PRICING RISK

The perfect assignment of risk would see the at-fault driver pay the full cost of the damage caused. Clearly, this is not a socially acceptable model for a variety of reasons.

On the opposite end of the spectrum the total annual estimated cost of claims and other costs could be divided by the number of policies sold, with no risk differentiation between policyholders. This benefits higher-risk drivers as their premiums do not reflect their higher propensity to cause a crash.

All insurance companies attempt to assign risk factors to differentiate drivers. The question becomes one of the cost of differentiation versus the benefit of fairer rates.

The government/ICBC asserts that the current design of the Basic rates does not reflect the risk posed by drivers:

> The model ICBC uses to help determine insurance rates is more than 30 years old. While it has seen some improvements over the years, it is out of date. This means that

[1] This is a follow-up to my 8 March 2018 "Commentary" paper; http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_rate_design_8_march_2018_copy/pdf/commentary_icbc_rate_design_8_march_2018_copy.pdf

> right now some drivers are paying more, and others are paying less than the risk they represent.
>
> British Columbians have been saying for years that the system would be more fair if lower risk drivers paid less for their insurance, and higher risk drivers paid more. We agree. Currently, most high-risk drivers are not paying enough to cover the future risks they represent on our roads.[2]

The government is citing the popular belief, rather than empirical evidence, that low-risk drivers[3] are paying a disproportionately large amount of the cost of Basic insurance. But is a popular belief sufficient grounds to change the current rate design; a design that ICBC admits is complex and blends both actuarial and 'social policy' (read political) considerations?

CURRENT MODEL

The primary tool used by ICBC (and the public insurers in Saskatchewan and Manitoba) to discriminate between policyholder risk is a *bonus malus* (discounts and surcharges) system that rewards or penalizes the vehicle owner based on actual at-fault claims. This Claim-Rated Scale (CRS) provides a discount of up to 43% for those with a certain number of claims free years, while the number of at-fault crashes can result in a surcharge of up to 205%.[4]

The CRS is based on the insured **vehicle**, not the driver/owner's crash record.[5] ICBC says that approximately 80% of vehicles insured qualify for the 43% full discount, and apparently this is a bad thing.

The CRS rating is applied to the vehicle premium after calculations for territory, use and other rating factors have been calculated. The combined 2015 Basic premium revenue of almost $2.8 billion included the CRS factor.[6]

To penalize high-risk driving behaviour (or encourage lower-risk driving behaviour) financial penalties are assigned to higher-risk **drivers** through three programs based on contraventions of provincial and Criminal Code driving laws. The Driver Penalty Premium (DDP) and the Driver Risk Premium (DRP) are based on cumulative points linked to traffic convictions, while the Multiple Crash Premium (MCP) is a specific financial penalty paid for multiple at-fault crashes.[7]

These financial penalties, which totalled $20.3 million in FY2015,[8] are paid by the driver and are separate from the vehicle insurance premium paid by the registered owner.

[2] http://engage.gov.bc.ca/ratefairness/
[3] Basic insurance premiums are paid by the registered owner (RO) or principal operator (PO).
[4] http://www.icbc.com/autoplan/costs/Pages/Claims-and-your-insurance-costs.aspx
[5] For example, a policyholder could have multiple at-fault crashes in one vehicle and none in a second insured vehicle. The premium for the first vehicle will reflect the poor crash history, while the premium for the second will not reflect the drivers' history in the first vehicle.
[6] Page 97 of http://www.icbc.com/about-icbc/company-info/Documents/ar-2017.pdf
[7] http://www.icbc.com/driver-licensing/tickets/Pages/default.aspx
[8] Page 37 of http://www.icbc.com/about-icbc/company-info/Documents/ar-2017.pdf ICBC does not split the driver penalty income between Basic and Optional in this summary. The 2016/17 information was for 15 months and not representative of a normal fiscal year.

ICBC did not provide data on the number of drivers who paid a financial penalty under the DPP program during the last year, so we do not know how prevalent these "high-risk" drivers are. We do know that in 2005 they constituted some 34,000 drivers, or about 1.2% of all drivers. Of the DPP drivers, some 2,900 cased a crash (8.6% of all the crashes in that year).[9]

From the 2005 data DPP drivers have a higher likelihood of causing a crash compared to a non-DPP driver, but the absolute numbers are small. Also, some 70% of the DPP-penalized drivers were the registered or principal operator of the insured vehicle, therefore most of the crash history would be captured in the CRS system and they would be paying a higher premium (in addition to the DPP financial penalty) as a higher risk driver.[10]

QUEST FOR PRICING PERFECTION

Unfortunately, ICBC has not provided current data showing the distribution of private vehicles in the various CRS categories, other than to note that approximately 80% qualify for the maximum 43% discount. One is left to wonder what proportion of the insured vehicles are in the surcharge category, and whether the situation is improving or getting worse.

We do have the information for the years 2004 to 2006. The distribution shown in Table 1 was provided by ICBC during the BC Utilities Commission's (first and only) 2007 Basic rate design review.

Table 1 -- POLICIES WRITTEN WITH CRS DISCOUNT or SURCHARGE

	2004	2005	2006
Full Discount	78.6	79.4	79.9
Some Discount	19.2	18.4	17.8
No Discount	1.3	1.3	1.4
Surcharge	0.9	0.9	0.9

Source: BCUC, ICBC Rate Design 2007, IR 1 BCOAPO 9.1.

During the three-year period less than 1% of the insured vehicles paid a surcharge, while close to 80% received the full 43% discount.

ICBC has stated that 80% of insured vehicles qualify for the full discount today. Can one conclude that a similar percentage of policyholders pay the actual at-fault surcharge?

ICBC may be concerned about the public perception of only 1% of policyholders paying the CRS surcharge. Perhaps a fairer description is that 80% of policyholders are paying the average rate and 20% are paying some form of penalty; **instead of only 1% paying a premium surcharge, ICBC can claim that 20% are paying more than the norm.**

[9] From BCUC, ICBC 2007 Rate Design, IR, IBC 14.1 to 14.4. Most ICBC policyholders are probably unaware of the separate penalty point financial charges because only a small proportion of drivers are affected (deemed high-risk).

[10] Ibid., IBC 17.1.

The government/ICBC seem to believe that pricing risk (the premium) on the actual at-fault crash history through the CRS is too limiting in pricing risk. Hence the emphasis on the driver-based penalties for traffic infractions. Convictions for traffic violations are seem as indicators of high-risk (to cause a crash) behaviour. Many of the proposals involve refining the assignment of risk to the driver, rather than the vehicle owner.

SPECIFIC PROPOSALS

Raising Driver-Based Financial Penalties

The three driver-based penalties (the DPP, the DRP and the MCP) make higher-risk drivers pay a financial penalty based on their traffic convictions. The additional financial penalties (approximately $20 million) are used to reduce the premiums for all policyholders.

The government/ICBC has proposed that the financial penalties attached to the points be increased by 40% over two years, to reflect the increase in the Basic premium rate during the last 10 years.[11] This is a strange rationalization as the government has derided the rapid growth in the average premium, rightly asserting that it is unaffordable given the much lower rise in the general cost of living.

The rapid increase in the Basic premium can be attributed more to rising injury severities not to the number of property damage crash claims. Crash frequencies have not increased by 40%, so why should the high-risk financial penalty?

Also, there is no evidence that the financial penalties result in better driving and fewer crashes. During the 2007 rate design review ICBC did not justify these programs as resulting in fewer crashes;

> ICBC has no specific expectation or estimates that behaviors will change and therefore, impact the frequency of claims.... ICBC does not have any evidence from other jurisdictions to support or refute the relationship between fines and/or premiums for driving convictions and its potential impact on driver behaviour and claims costs.[12]

In the absence of this justification the proposal to increase the driving penalty points financial penalty seems designed to generate additional "other revenue." ICBC can then offset the increased revenue with targeted discounts.

Optional Insurance Rate Design

The current review of rate design seems to be primarily focused on the compulsory Basic insurance. Presumably, because the Optional insurance competes on price and coverage

[11] http://engage.gov.bc.ca/ratefairness/topic-3-drivers-with-minor-and-serious-convictions/ The cumulative Basic rate has increased by 45% in the last six years; ICBC understates the increase by using 10 years.
[12] BCUC, ICBC 2007 Rate Design, IR 1, BCOAPO 49.3.

with insurance offered by private insurers, and ICBC has enjoyed a market share of about 90% for many years, the current rate design is acceptable.

ICBC has not provided an explanation of how the Optional rate design differs from the Basic design.

The proposal respecting using traffic violation convictions to set Optional insurance premiums needs more explanation.[13] The individuals in the examples given would (presumably) be paying applicable DPP and DRP financial penalties.

Widening the Operator Net

The list of ways to refine the determination of driver risk includes a proposal to not only base the premium on the registered owner (RO) or principal operator (PO), but to require the listing of other potential operators. This is justified on the belief that many crashes are caused by drivers who are not the RO or the PO (presumably the principle target group are children of the RO living at home).

A high-risk driver who is not the RO or the declared PO will still incur financial penalties under one or more of the penalty points programs (otherwise they would not be classed as high-risk). Therefore, ICBC is now attempting to assign more of the cost of crashes to the driver who is not registered as the PO or the RO.

While this may be considered a fairer apportionment of the cost between low and higher-risk drivers, one must question whether the cost of the ultimate result is worth the cost of seeking perfection. The proposal as presented[14] appears cumbersome, would require the active support of the broker community, and may involve significant changes to ICBC's information software and other systems.

It is unclear what – if any – financial savings will result from this significant change to the current business model. ICBC did not provide an estimate of the additional revenue or cost.

Forbid Paying Minor At-Fault Damage Claims

ICBC states that approximately 10% of at-fault drivers repay vehicle damage claims, thereby avoiding higher CRS premiums. The suggestion is that this is a bad thing because "the driver's true risk level is not reflected in their insurance rate going forward."[15]

Assuming these are minor damage claims, if ICBC paid the claims this would significantly increase the frequency and decrease the severity of the average property damage claim. Forbidding individuals from paying minor "fender-benders" to avoid three or more years of significantly increased premiums seems mean and appears to be

[13] http://engage.gov.bc.ca/ratefairness/topic-3-drivers-with-minor-and-serious-convictions/
[14] http://engage.gov.bc.ca/ratefairness/topic-1-claims/
[15] Ibid.

an attempt to increase the premium revenue (fewer CRS discounts) under the guise of rate fairness.

Allow Claims-Free Drivers to Earn Greater Discounts

At 43% the ICBC discount model is already more generous than that of the Basic programs in Saskatchewan and Manitoba. ICBC has not provided any estimates of what increasing the discounts could cost, but at a time when ICBC is incurring massive operating losses this proposal seems irresponsible.

Perhaps ICBC intends to indirectly fund the discount increase with the proposed 40% increase in the driver financial penalties. These are very different programs and should not be related.

Reduce the Seniors' Discount

The proposal to reduce the 25% discount on the Basic premium for those 65 and older who cause a crash confuses the purpose of the discount.

The proposal is a form of double jeopardy as an at-fault senior will suffer a change on the CRS and lose some of the financial benefit of the seniors' discount. The discount is required by government policy and has nothing to do with the senior's driving record.

ICBC should be demanding the government fund the approximately $100 million that the policy is costing other Basic policyholders (whose rates are higher to make up the foregone revenue).[16]

Total Kilometer Discount

The notion that a vehicle driven less than 5,000 kilometers per year should receive a discount runs counter to the purported shift to a more driver-based pricing of risk (as the driver may have driven much more in other vehicles). Also, while it intuitively seems correct to assume that more kilometers driven increases the risk of a crash, where the vehicle is driven is more important.

ICBC made this point in its 2007 material: "Distance driven alone… is not necessarily the best indicator of risk of causing crashes (e.g., 100 kilometres driven on a highway generally represents less risk than 100 kilometres driven in urban or rush hour traffic). Claims history and driver convictions are better predictors of the risk of causing crashes."[17]

Does ICBC have new crash causation data to justify a kilometer discount? Does not the "for pleasure" factor equate in some measure for limited use?

[16] For additional information see http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_47_4_december_2017/pdf/occasional_paper_no_47_4_december_2017.pdf

[17] BCUC, ICBC 2007 Rate Review, IR 2, BCUC 69.3.

The Role of the BC Utilities Commission

The BC Utilities Commission has the statutory authority to approve the rate design model for the Basic program. Once the government has reviewed the responses to the public consultation, and has agreed on the key changes to the current rate design model, is it going to allow the BC Utilities Commission to make significant alterations in that proposed model?

Why is the government inserting itself into the ICBC-BCUC relationship? It could be that it believes that any changes to the current model may lead to political consequences, therefore it is better to be seen by the public as leading the effort. Or, the government may believe that to ensure sufficient support for the changes to the Basic coverage for injury claims it needs to be responsive to the perceived belief that the current rates are unfair to good (low-risk) drivers.

It remains to be seen if the intervention strategy is the correct approach, or if it raises expectations for lower rates that may be impossible to fulfill given the financial difficulties at ICBC.

In summary, the current public consultation respecting the design of ICBC's premiums suffers from the lack of empirical information or studies to justify the changes that are being proposed. ICBC has proposed a tightening of the CRS, and a focus on assigning risk and cost to drivers who are neither the owner or the principal operator. This is justified as promoting a fairer apportionment of the costs, but little or no proof has been presented that this will reduce crash rates or claims costs.

ICBC will be expected to provide this analysis and detailed justification when it applies to the BC Utilities Commission for approval of any changes to the existing complex rate design model. Rather than simplifying the rate design, the proposals would make the design more complex, contrary to a fundamental principle of pricing.

 http://www.bcpolicyperspectives.com/

The writer is a retired senior BC government public servant whose paper describing the BC government's manipulation of the finances of BC Hydro from 2008 to 2014 was published by *BC Studies* in November 2016. *BC Studies* published his paper on the 40-year financial history of ICBC in 2013. He has been an intervener in the BC Utilities Commission's recent reviews of both ICBC's and BC Hydro's rate requests.

APPENDIX – PREVIOUS ATTEMPTS AT CHANGE

The 2011 False Start

ICBC has been attempting to give greater prominence to the risk of drivers, as opposed to vehicles, in its financing of insurance for many years. The main thrust of the 2007 rate design proposals presented to the BC Utilities Commission was the DRP, which was supposed to replace the DPP program.

In 2011 ICBC tried again to increase the DPP financial penalties for traffic offenses claiming one-third of drivers would pay more to provide a discount to two-thirds of drivers. While this may have been statistically fairer, the driving public rightly objected that a single speeding ticket could result in a financial penalty in addition to the provincial fine.[18]

The Liberal government stopped the initiative before a proposal could be presented to the Utilities Commission. Jon Schubert, ICBC's president, said that ICBC would rethink the proposals and undertake more public consultation,[19] but the consultation did not occur as ICBC became absorbed in responding to a government review of its operations.[20]

Since 2011 ICBC has not adjusted its rate design methodology or rebalanced its vehicle risk weightings despite the 6-7% annual addition of new passenger vehicles.

The 2017 CRS Changes

In May 2017 ICBC announced that the rules governing CRS would be changed to make it easier to lose the safe driving discounts, especially for those at the maximum discount level.[21]

The current proposed changes to the CRS are even tougher, as it will take longer to regain the previous full discount level.

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[18] https://www.theglobeandmail.com/news/british-columbia/liberals-reject-icbc-rate-hike/article580022/
[19] http://www.cbc.ca/news/canada/british-columbia/icbc-withdraws-controversial-rate-hike-proposal-1.1031991
[20] The review resulted in tighter government control over ICBC's finances and the 2013 limit on Basic rate increases.
[21] http://www.icbc.com/about-icbc/newsroom/Pages/2017-Mar3-01.aspx