

Reforming BC Auto Insurance to Benefit Consumers

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Executive Summary

British Columbia's Attorney General has described the state of the government-owned Insurance Corporation of British Columbia (ICBC) as a "dumpster fire" and was justified in doing so. The Corporation lost \$1.3 billion in 2018 and a further \$1.2 billion in the following year. These losses had totally exhausted ICBC's capital and regulators would have shut down a private insurer in the same condition a long time ago.

The sad state of ICBC's finances results from government interference. It has been saddled with financial responsibilities uncommon for other auto insurers: the BC government drained off \$1,050 million from ICBC into general revenue between 2010 and 2015 and has limited its ability to raise its premiums. The cap on rates has caused ICBC's revenue to rise more slowly than its costs. In 2018, the cap alone caused a revenue shortfall of \$415 million.

ICBC's insurance costs are generally the highest in Canada and are even higher when its losses are taken into account. As a monopoly it lacks any competition to keep its rates low and to provide a benchmark for its performance.

The present BC government deserves credit for tackling the dumpster fire. It has introduced legislation to prevent further raids on the ICBC piggy bank. It has also made the insurer's operations conform to commercial principles by requiring bad drivers to be responsible for their performance and by charging beginning drivers more than others. As a major step, it also plans to introduce no-fault insurance. How much these measures will improve ICBC's financial condition remains uncertain.

These measures, however, do nothing to solve the source of ICBC's problems: it will still be owned by the government, with the overhanging threat of government interference. It will continue as a monopoly without the pressure of competitors to keep its rates low.

Many have called for the privatization of ICBC. But privatization can be done in different ways and the way that is chosen matters. ICBC could be privatized in the way that the previous government sold BC Hydro's gas division as a complete unit to a private interest. The sale solved the problem of government ownership but left the monopoly for gas distribution in private hands. Opening up British Columbia's basic automobile

insurance business to new competitors would be the best way to privatize automobile insurance. This reform would foster innovation and lead to lower consumer premiums than the alternatives.

Unfortunately, ICBC has placed a major obstacle to competition by its unwillingness to share drivers' records with other insurers. Such records are vital to insurers trying to sort bad drivers from good. This lack of information sharing has already stifled the competition from private insurers allowed to do business in the optional market. It will do the same if competition is permitted in the larger basic market. Unless this obstacle is removed, private insurers cannot be significant competitors in the basic insurance market and may avoid the market entirely. Information sharing among insurers must be part of any reform to introduce competition.

The Government's recent measures to stem the flow of red ink at ICBC should not be the end of reform. Opening the market to competition is the best way to benefit consumers and should be the next step.

Introduction

In 2018, the Attorney General of British Columbia described the state of the government-owned Insurance Corporation of British Columbia (ICBC) as a “dumpster fire” (Proctor and Larsen, 2018) and was justified in doing so. ICBC’s insurance premiums are generally the highest in Canada. The Corporation lost \$1.3 billion in 2018 and a further \$1.2 billion in the following year (ICBC, 2019f: 9). Continued losses of this size may leave ICBC unable to meet its customers’ claims without a government bail-out, which would come at the tax payer’s expense.

This paper is the third in a series dealing with ICBC’s current state and possible reform. The first, *The Decline and Fall of ICBC* (Chant, 2018), documented the perilous state of ICBC’s finances. The second, *Understanding Why Basic Auto Insurance Rates in BC Are So High* (Chant, 2018), showed how high rates for many drivers resulted primarily from ICBC’s failure to account for the risks posed by drivers of different ages in setting its rates.

The purpose of this instalment is to examine different approaches for reform of the province’s market for automobile insurance, to compare their advantages and disadvantages, and to note the obstacles along the way. Calls have been made to reform ICBC, and it is clear that significant changes are needed. There also must be a vision of what the automobile-insurance industry should look like.

ICBC's Financial Problems

The sad state of ICBC's finances results mainly from government interference. The Crown Corporation has been saddled with financial responsibilities uncommon for other automobile insurers. The BC government drained off \$1,050 million from ICBC into general revenue between 2010 and 2015, a step that has come at the cost of reducing ICBC's investments, earnings from which have traditionally supplemented premiums as a source of finance to help meet customers' claims. The loss of assets is especially important to the Corporation, given a declining rate of return on its remaining investments. The contribution of investment returns to ICBC's overall revenue as share of costs has fallen from 12% of costs in 2015 to just 6.5% in 2017 (Chant, 2019: 9).

The government has also limited ICBC's ability to raise its premiums through a cabinet directive, the "Special Direction IC2 to the British Columbia Utilities Commission" (BC Laws, 2020), that restricts changes in its premiums to no more than 1.5% above the previous year's change, causing ICBC's revenue to rise more slowly than its costs. In 2014, the first year the rate cap took effect, ICBC would have required an 11.5% rate hike to cover its costs, but it received approval for only a 5.2% increase. The cap led to a revenue shortfall of \$115 million in 2015, which eventually grew to \$415 million by 2018 (Chant, 2019: 8).

ICBC bears certain government-determined expenses in addition to those faced by private insurers. It licenses BC drivers and vehicles at no charge to the government and transfers all the fees to the government without any compensation and conducts road safety programs at a direct cost of \$101 million in the year ending March 2019 (ICBC, 2019f: 9).

Changes in the adequacy of ICBC's capital provide a further perspective on its financial decline. Automobile insurers, like most other insurers, are required to hold capital as a buffer that allows them to meet their claims in the event of unfavourable conditions. The Minimum Capital Test (MCT) established by the federal Office of the Supervisor of Financial Institutions (OSFI) serves as a standard for itself and other Canadian regulators to assess the financial risk and long-term stability of the financial institutions they

supervise. The MCT shows the ratio of available capital to capital required, where available capital consists of an insurer's surplus (current premium revenues less operating costs), retained earnings, and certain reserves.

ICBC is not subject to regulation by the BC agency that regulates other insurers. Rather, the provincial government itself sets the minimum level of available capital for ICBC's basic business—one of the ways the government intervenes in ICBC's affairs. This requirement was set in 2005 to be at least 100% of OSFI's MCT. At the same time, ICBC management set an internal target of 180% of MCT.

ICBC's MCT reached its peak of 240% in 2009 and has fallen ever since. By 2017, ICBC forecast in its *Statements and Schedules of Financial Information* that its MCT ratio would drop below the required minimum in 2018, and then continue to fall, predicting that capital for its basic business would be totally exhausted by 2021 (ICBC, 2019e). As a result, in February 2018 BC's Attorney-General took the extraordinary step of suspending ICBC's capital requirement through to 2020.

It has now turned out that the decline of available capital has been even more rapid than ICBC had predicted when the MCT fell to -7%, indicating a negative capital position at the end of the 2018/19 fiscal year (ICBC, 2019b: 3). Without the government's suspension of the capital rules, ICBC would have been technically insolvent from a regulatory perspective.

The government has treated ICBC quite differently from the way regulators would have treated a private automobile insurer. Facing such a decline in an insurer's capital, a regulator would have first issued successive warnings to the insurer to strengthen its capital and, if the situation did not improve, then move to place limitations on its business. The regulator would likely take the drastic step of closing the insurer's business well before its MCT turned negative.

The forced cash transfers to the government, the cap on ICBC's rates, and the need to provide non-insurance activities are symptoms of ICBC's underlying problem: it is subject to government interference. A government may direct an insurer it owns to act in ways that it would not do with a privately owned industry.

Early experience in British Columbia plus experience with government ownership in other provinces shows that costly measures do not always follow from government

ownership. The Saskatchewan Auto Fund as a non-profit neither receives money nor pays dividends to the province (Crown Investments Corporation of Saskatchewan, 2020). Moreover, it has been able to maintain a capital ratio of 150% compared to ICBC's -7% (SGL, 2019: 63; ICBC, 2019a: 12). But when the BC government's finances were strained after the 2008/09 recession and global financial crisis, the government chose to drain funds from its insurer. Then, when escalating automobile insurance rates became a hot-button political issue, the government acted to suppress insurance rates and costs.

The Cost of Insurance

The cost of insurance indicates the extent to which any insurer serves the interests of its customers. Lower costs for a given policy indicate a more effective and better managed insurer. Measures of customer costs have been used by the Insurance Bureau of Canada (IBC), Devlin, and MNP LLP to compare the effectiveness of ICBC relative to other insurers in Canada. The measure would be most meaningful when the comparisons are of provinces or cities that have similar conditions such as their weather, degree of urbanization, traffic congestion, and the coverages included in each policy, as well as “the legal options available to a claimant, provincial regulatory requirements, the population density of a province or a particular city, repair costs, the statistical makeup of the insured population (a greater proportion of seniors or a greater proportion of young males) (Milke, 2017: 10).

The cost to customers fails to capture all of the costs of insurance when a public insurer suffers losses. In this case, overall costs of insurance exceed the customers’ costs because the losses are borne by the general public as the insurer’s owner. Such losses should be added to premium revenues to determine the true overall cost of insurance. In the case of ICBC, these extra costs were \$1.2 billion in 2017/18 (equal to 22% of its premium revenue), and \$1 billion in 2018/19 (18% of its premium revenue) (ICBC, 2019f: 9).

Measures of basic insurance costs

The Insurance Bureau of Canada’s measure

The Insurance Bureau of Canada uses an overall measure of basic insurance costs in the country that is based on the average premium for drivers in ten provinces for 2018/19 (IBC, 2019). Their measure was derived by dividing total premiums collected from passenger vehicles by the number of insured vehicles. This measure indicates that British Columbia’s average premium of \$1,832 was the highest, exceeding Ontario, the next highest, by \$327, and Alberta, the third highest, by \$516 (IBC, 2019). Taking ICBC’s losses into account for the IBC comparisons raises the total cost per BC policy to \$2,242, compared to the customer’s stated cost of \$1,832. This adjustment raises British Columbia’s excess cost per policy to \$737 over Ontario and to \$926 over Alberta.

The Devlin and MNP LLP measures

In contrast, Devlin and MNP LLP have used premium quotations for a hypothetical representative driver to compare insurance costs across provinces. Devlin's study covered May to June 2017 for the largest cities in all ten provinces. [1] MNP LLP made similar comparisons for 2019 between British Columbia and Alberta.

Devlin compared premiums for both required and complete coverage using a male driver aged 45 driving a Honda Civic under a variety of driving records (Devlin, 2019: 10–11). The average quotation for basic insurance for this driver with a clean record in British Columbia was \$1,087, the fourth highest among nine provinces, trailing Ontario, the highest, by \$1410. [2] Devlin concludes: "Prices in Vancouver BC are in the middle of the pack and are much lower than in Ontario for a driver with a good record in Toronto" (Devlin, 2019: 14).

The cost of insurance in British Columbia for Devlin's comparisons adjusted for ICBC's losses increases from \$1,082 to \$1,330. This adjustment reduces the gap between Ontario and British Columbia from \$1,377 to \$934 and makes ICBC's average premiums the second highest among provinces. [3] Devlin's cost comparisons must be used with some caution: her choice to use the largest city in each province has produced a diverse group of cities ranging from Toronto with a population of 5.9 million to Charlottetown with less than 50,000.

Finally, MNP used quotations to compare automobile-insurance premiums in British Columbia and Alberta for February 2019 (MNP, 2019: 7). [4] Their comparisons covered 14 pairs of drivers in different locations across the two provinces. MNP found that ICBC's rates exceeded those of Alberta in 12 of the 14 comparisons. The margins were small in the two cases where BC rates were lower: \$18 (2%) for a senior in a large urban area, and \$41 (2%) for an inexperienced driver in a large town. The differences were greater for the cases where BC rates were higher, ranging from \$117 (9%) for a senior in an urban area to \$765 (52%) for multiple drivers including a learner also in an urban area. The adjustment for ICBC's losses makes its rates higher than those in Alberta in all cases, with the differences ranging from \$172 (15%) to \$1,144 (78%).

[1] Personal communication from R. Devlin, Professor of Economics, University of Ottawa, via e-mail, October 17, 2019.

[2] Quebec was not included in the sample.

[3] The estimate for Manitoba has been adjusted for the 2017/18 auto-insurance losses of the Manitoba government insurer (Manitoba Public Insurance, 2018).

[4] MNP used the three lowest quotations out of eight provided by an insurance broker (MNP, 2019: 9).

ICBC has criticized the MNP's estimates, claiming that the BC system, local cost pressures, and the levels of coverage are very different from those in Alberta. In particular, ICBC claims that "our medical care benefits will be six times those offered in Alberta, our wage loss almost double and our death benefits triple" (ICBC, 2019c).

The costs arising from the differences identified by ICBC do not appear to be enough to account for the premium differences. The costs of wage-loss protection and death benefits are very small relative to overall claims—1% and 1/10%, respectively—so that differences in this area would have a negligible effect on overall premiums. Medical rehabilitation costs, on the other hand, account for more than 5% of total claims. The difference noted by ICBC, however, refers to the ceiling for this type of claim: \$300,000 for BC versus \$50,000 for Alberta. ICBC's average medical claim of \$3,764 suggests that few claims would be affected by the higher limits (ICBC, 2019a). Indeed, the Attorney General stated that only 30 to 40 of the approximately 58,000 claims in this category, or less than 0.1%, reached the previous limit of \$150,000. [5]

Summary—insurance costs

Several studies have made comparisons of premiums quoted for auto-insurance rates in British Columbia with those of other provinces. The results are mixed: IBC found BC's rates to be the highest among the provinces, Devlin found them to be in the middle of the pack, and MNP found that British Columbia's rates in most cases are higher than those in Alberta. When the losses incurred by ICBC are taken into account, ICBC's rates are uniformly higher than those elsewhere, with the exception of Toronto, often by substantial margins.

Higher rates can be an indication of the types of drivers obtaining insurance and differing road conditions, on the one hand, and more costly insurance operations, on the other. The differences as reflected in premiums appear to be greater than what can be accounted for by the insurer's operating environment. On the whole, the evidence indicates that ICBC is a costly supplier of automobile insurance relative to others, both public and private, in Canada.

[5] Quoted in MNP, 2019: 30, note 50. Number of claims from ICBC, 2019d.

The Case for Government Ownership of Automobile Insurance

The general case for government ownership [6]

The ownership of automobile insurers differs by jurisdiction. Some insurers, such as those in British Columbia, Manitoba, and Saskatchewan, are government owned, while insurers in other provinces, the United States, and the United Kingdom are privately owned. This section briefly reviews the general case for government ownership and how it applies to automobile insurers.

The economic case for government ownership differs from industry to industry according to the nature of the industry in question. In a classic article, Shleifer (1998) suggests that the case for government ownership depends on the following considerations:

1. possible deterioration in the quality of services supplied by the private sector;
2. the importance of innovation;
3. weak competition in the market and ineffective consumer choice;
4. the importance of reputation in determining demand.

1. Deterioration of quality

Deterioration of quality will be a concern when a government purchases services from private suppliers because of the difficulty in writing contracts that specify all dimensions of the service. Suppliers then have an incentive to cut costs in the under-specified dimensions. Government ownership, however, readily allows for the revision of specifications when a need becomes apparent. This argument applies most strongly where private concerns supply services such as prisons, hospitals, and schools on behalf of the government. Just specifying the offering of three meals a day would be inadequate because the content of the meals remains unspecified. But any specification of the content of the meals will also be incomplete, as high-quality food could be replaced with cheaper alternatives. The case for government ownership, it is argued, rests on the resulting weaker pressure to keep costs down while maintaining the level of service compared to the situation with private ownership.

[6] This section is based on Schleifer, 1998.

2. Scope for innovation

Private supply and government supply differ in the scope for, and likelihood of, innovation they offer. Private suppliers gain from innovation through the returns derived from its successes and, as a result, often will seek to innovate for commercial, profit-seeking reasons. This incentive will be blunted or absent in the public sector, where managers are not owners and are less likely to gain economically from their innovations and where the “shareholder”—that is, the state—is not generally motivated to maximize or even generate profits. These differences may not matter in industries with a limited scope for technical progress but they arguably do matter in industries with a rapid pace of change.

3. Weak competition

Weak competition enables suppliers to profit by using their protected position to charge high prices at the expense of their customers. Government suppliers, on the other hand, could operate with a mandate that requires them to keep their prices lower while still avoiding losses. Government ownership is not the only remedy for such natural monopolies. Regulation provides one alternative for dealing with natural monopolies. Alternatively, Demsetz (1968) has proposed that natural monopolies can be dealt with by a bidding process through which competing suppliers seek to reach contracts with buyers. These contracts could include commitments with respect to prices and quality of service together with other dimensions.

4. Reputation

Building a reputation is one way that businesses can assure they have customers in the future. Concern for their reputation may discourage businesses from cutting costs and otherwise taking steps that lower quality. Where reputation is important, suppliers will strive to build their reputation by providing good quality for their goods and services. The importance of reputation in an industry weakens the argument for public supply.

Among the factors determining the significance of reputation in an industry are the importance of repeat customers and the nature of the product that is sold. A supplier will avoid taking advantage of repeat customers because it would jeopardize the supplier’s chances of serving these customers in the future, assuming a competitive product market exists.

The nature of the product also affects the importance assigned to a firm’s reputation. Reputation will be less necessary where customers can inspect the product to determine its quality before purchasing. It is also less necessary in industries where the good or

service is provided simultaneously with the purchase. On the other hand, developing a positive reputation will be important in industries where product quality is difficult to determine or when the services are provided some time after the purchase.

Government supply of automobile insurance

How do Shleifer's criteria for government ownership apply to automobile insurance? Is there potential for deterioration of quality? Is innovation important to the industry? Can the market be competitive? Does reputation matter for insurers? In each case, the considerations will be reviewed as they apply to private insurers and the performance of ICBC.

1. Deterioration of quality

Automobile insurance, like any other insurance, offers scope for deterioration of quality. Customers pay for insurance in advance while the benefit from the insurance—the settlement of claims—is uncertain and takes place in the future. Customers will be concerned about the quality of the settlement in terms of the effort they need to make to have their claims recognized and the degree to which the settlement will reflect their loss.

Competitive markets and monopolies differ with respect to the resolution of these tensions. With a monopoly supplier, the balance of power lies with the supplier because customers have nowhere else to turn other than costly and unpredictable litigation. On the other hand, a customer who has experienced poor service in a competitive market can transfer its business to other suppliers. Car insurance is purchased annually, giving private suppliers incentives to develop a reputation for reliability in order to keep and attract customers.

Developments in British Columbia suggest that governments themselves have been willing to dilute the quality of insurance when cost pressures would otherwise push rates higher and thus spark public criticism. Faced with ICBC's eroding finances, the BC government moved to reduce costs by, among other means, setting limits on damages for pain and suffering. ICBC and the government that controls it acted as if the dilution of service would be more acceptable to customers than higher insurance rates. The dilution of quality takes place in the future, after claims are filed, and affects only that small proportion of customers who have claims, making it less visible than higher insurance prices—which hit all customers.

2. Innovation

ICBC has lagged in introducing new services for customers. Mileage-based premiums were introduced in British Columbia long after they had become common elsewhere. Car licenses in the province must be renewed by the owner in person, even though such

renewals can be done by phone or the internet elsewhere. [7] The recent shift from owners to drivers as the basis for setting insurance rates had already been the standard practice “in virtually every other jurisdiction in North America” (James Beaulieu, quoted in Penner, 2019).

3. Prospect for competition

A lack of competition in automobile insurance, if it existed, could provide grounds for government participation or public ownership. The experience in Alberta and Ontario suggests that numerous suppliers would enter the market under the right conditions. Over 60 suppliers operate in the Alberta market and over 70 in Ontario, where the largest insurer there holds less than 12% of the market. These numbers suggest the presence of an adequate number of suppliers to assure competition. There is no reason to believe a private car insurance market in British Columbia would suffer from a paucity of competition.

4. Importance of reputation

Customers in the automobile-insurance market will tend to seek out well-established, financially strong insurance suppliers because claims are settled in the future. The composition of insurers in Ontario suggests that reputation matters. All Ontario insurers with a market share of more than 5% are large national or international insurers and account for over half of the total market.

[7] In response to the Coronavirus outbreak, ICBC has announced that drivers can finally renew their policies by phone or email (Shaw, 2019).

Approaches to Reform

ICBC could be reformed by a variety of approaches, each with different features. Reforming through commercialization, while leaving ICBC's ownership and monopoly position unchanged, would make its operations correspond more closely to those of private insurers. Alternatively, the government could privatize ICBC by transferring ownership to a private entity while preserving its monopoly position. Finally, the insurance market could be opened to competition from multiple suppliers.

Commercialization [8]

Adoption of commercialization would mean that ICBC would be focused on providing any degree of automobile insurance as cheaply as possible. But government enterprises like ICBC differ from commercial businesses performing the same activities in that they may have, in addition to their primary function, social and political objectives that are mandated by government. This is certainly the case with ICBC.

In addition to its non-insurance activities, ICBC departs from commercial principles in its premium structure that takes no account of drivers' ages or gender. This policy results in higher premiums for older and female drivers than are warranted by expected driving experience (Chant, 2019). All drivers younger than 34 years have paid less than they would if premiums were based on the accident costs for their age group. These lower premiums for riskier drivers mean that drivers aged 35 and over pay premiums that are higher than their average accident costs.

The other objectives pursued by ICBC can interfere with the efficient operation of the core insurance business, increasing the costs to customers. The pursuit of these objectives also may obscure whether the enterprise is fulfilling its primary objectives effectively. ICBC could avoid these problems through commercialization, which would give it "a clear set of commercial, as opposed to public policy, performance objectives" (McFetridge, 1997: 6). The Corporation together with the BC government has already taken steps toward making the ICBC's operations conform to the standards of commercial insurers.

[8] For a discussion of commercialization, see McFetridge, 1997: 6.

In February 2018, the BC government introduced a package of measures to reduce ICBC's claims costs; these included a \$5,500 limit on pain and suffering for minor injury claims, a step that brought BC into line with other Canadian provinces (BC Attorney General, 2018a). The package also included an independent process for resolving disputes through the existing Civil Resolution Tribunal for certain injury claims. These changes were designed to save on the costs of settlements and also reduce ICBC's legal costs. The Attorney General estimated that the changes would save ICBC around \$1 billion per year. A year later, the government changed the court rules to reduce costs and delays in dealing with damages arising from automobile accidents by limiting the use of experts and the number of expert reports (BC Attorney General, 2019). These changes limited the use to one expert and one report for smaller claims (up to \$100,000) and as many three experts for other, larger claims. In October 2018, however, this government-imposed measure was overturned by the Chief Justice of the BC Supreme Court on the grounds that court procedures were matters for the courts and not the government to decide, thus nullifying any savings ICBC expected from the change. [9]

The BC government also announced measures in August 2018 that would shift the cost of accidents so that drivers' premiums would reflect their driving records, their crash history, and the level of risk they pose (BC Attorney General, 2018b). The centrepiece of the proposals shifted the basis for setting insurance rates to a vehicle driver rather than its owner. This step stops risky drivers from avoiding the consequences of their poor driving by using cars owned by other parties. The measure also indirectly tackled the issue of young drivers and their greater frequency of accidents. Drivers with less than a 5-year driving history will have to pay higher premiums than other drivers. This policy captures all drivers younger than 21 in addition to older beginners. It effectively includes age as a factor leading to higher insurance premiums for all younger drivers.

The BC government announced in February 2020 a major change to automobile insurance in British Columbia through the introduction of Enhanced Care coverage, a form of no-fault insurance in their effort to bring ICBC costs under control. This change raises a number of questions. What is no-fault insurance? How would no-fault reduce ICBC's costs? No-fault automobile insurance differs from liability-based insurance in that both parties to a crash would be compensated by their own insurance company regardless of their fault. The innocent parties together with the responsible drivers would receive compensation that depends on their insurers' schedules for damages.

[9] See: *Crowder v. British Columbia (Attorney General)*, 2019 BCSC 1824. <<https://www.bccourts.ca/jdb-txt/sc/19/18/2019BCSC1824.htm>>, as of March 6, 2020.

Unlike the procedure under liability insurance, the parties will not have the opportunity to sue for damages. Rather, the government claims “the planned legislation will require ICBC, by law, to assist every person who makes a claim and endeavour to ensure they receive all of the care and benefits to which they are entitled” (BC Attorney General, 2020). It also states that customers will have recourse if they are dissatisfied with the treatment of their claim through a number of channels including the Civil Resolution Tribunal, British Columbia’s Office of the Ombudsperson, and a proposed ICBC fairness officer. It suggests that customers would not need a lawyer to use these options.

Under no-fault insurance, the claims of the drivers responsible for the accident would be treated the same as those of other parties and they would not be liable for damages as they are at present. Still they will, as a result, face higher future insurance premiums as they do under the current system.

By adopting a no-fault system, the government plans to eliminate legal fees and other costs of litigation associated with the current system. These costs include ICBC’s own legal expenses together with the customers’ legal expenses that currently form part of their settlements. It expects that these changes will lower the costs of ICBC coverage by 20%, or \$400 for each policy (BC Attorney General, 2020).

Transfer of ownership

The government could also reform ICBC by transferring its ownership to a private party. The sale of BC Hydro’s natural-gas division to a private corporation, and of Canada’s air-control system to Navcan, a non-profit corporation, are recent examples of privatization through ownership transfer. The case for transferring ICBC wholly to a private corporation or non-profit differs substantially from these examples as both of these activities are natural monopolies. One set of pipes for gas distribution would be sufficient to service the customers in a given geographic market. The introduction of additional competitors into the market would require a duplication of delivery facilities and thus higher costs. Similarly, the presence of more than one authority for air control in a region would lead to chaos in the air. Some planes would be directed by different controllers than others, and no given controller would have an overall view. These markets, as a result, are appropriately organized as monopolies.

Transfer of ownership would eliminate only one of ICBC’s problems: those arising from government ownership. The monopoly problem would still remain. Moreover, the transfer to private interests would make the monopoly over automobile insurance permanent.

Opening up the market

Finally, the insurance market could be reformed by opening it up to competition. Such an approach would eliminate both the monopoly and the problem of government ownership. Greater competition could be achieved either by breaking up a state-owned monopoly by selling off its parts or by fostering the entry of new enterprises to compete in the market.

The privatization of liquor distribution in Alberta combined both approaches. Government liquor stores were sold off to private interests while new private stores were allowed to open. West (2003) has described this privatization as benefitting customers by lowering prices, increasing consumer choices, and making shopping more convenient. The privatization, however, was confined only to retail sales and did not change the government-owned system for wholesale distribution. [10]

Even though breaking up Alberta's retail distribution was an important element in its privatization, the structure of Alberta's retail liquor distribution system differs sufficiently from that of automobile insurance that it does not serve as a useful example for ICBC's privatization. The break-up of retail liquor distribution was possible because of the system's horizontal organization. Multiple branches within the organization offered retail sales and, in effect, could be operated independently of each other. As a result, they could be sold off separately as fully functioning outlets. ICBC, in contrast, is organized vertically with functions that support each other. Underwriting, investment management, and claims management/adjustment are each vital to an auto-insurance operation. With a break-up of ICBC ruled out, opening the market to new entrants is necessary to reform the market so it is more competitive.

[10] This same degree of privatization does exist in the BC automobile-insurance market. Private brokers are the retail outlets that serve ICBC, the supplier of the insurance.

Assessment of Reforms

Sustainability

Reform of the automobile-insurance market does not guarantee that the reforms will be sustained. Just as governments can introduce reforms, they can later reverse them. An election can put a government in power that is determined to undo the previous government's reforms: a government that finds its finances tight might be tempted to syphon funds from the Crown-owned insurer; or a government that discovers that automobile-insurance rates have become a political "hot potato" may be tempted to cap rates, as has happened on a number of occasions in British Columbia.

Among the options for reform, commercialization arguably will be most vulnerable to political interference. Here the corporation will remain government owned and the government can shape the corporation's policies through directives or by revising its mandate. Commercialization also tends to progress in an incremental way and as result is vulnerable to being slowed or even halted by opposition from groups who not support specific changes.

The vulnerability of a private monopoly to government intervention lies between that of a government corporation and true market competition. The government would need to take more open and explicit action to influence the monopoly's policies, leaving it open to public and media criticism. On the other hand, the fact that a monopoly had invested a lot in the BC market could make it inclined to bend to the government's wishes.

Governments may be unable to resist intervening in a competitive market through rate caps and product demands. Still, a competitive insurance market will be most immune to political interventions because private insurers can sidestep government pressures in a way that a government-owned insurer or a monopoly insurer cannot: ultimately, they can leave the market if the government's demands make their business unviable.

Benefits to customers

Lower rates

A major benefit to customers from any particular set of reforms could be lower insurance costs. The reform options discussed above differ in the benchmark they provide for assessing rates and the pressures they create to achieve the benchmark.

Neither commercialization nor the sale of the insurance monopoly provides a benchmark for setting insurance rates. Rates are often compared with rates in other jurisdictions yet, as we saw, the features that influence insurance rates differ in each jurisdiction. Both commercialization and the sale of the monopoly supplier lack pressures that will drive insurance rates down toward the lowest levels possible. While high insurance rates may deter some from driving, the effect will likely be small, and customers will be unable to switch insurers when rates are too high because, in both cases, insurance will be offered by a monopoly.

An open, competitive market, on the other hand, offers the greatest scope to reducing insurance rates over time. Customers are able to seek quotations from a variety of insurers and even to compare them on the Internet. [11] Any insurer in such a market faces the benchmark of the rates charged by other suppliers together with pressures to compete in order to capture and retain customers' business.

Innovation

Commercialization of ICBC will be the option least favourable to innovation because of government ownership and the limited incentives for innovation. The effects of a transfer of ownership will depend on the new owner. The competitive option has the strongest effect on innovation. Not only are there strong incentives for private owners to be innovative, but the number of firms in a competitive market means there will be more potential sources of innovation and that firms have incentives to innovate in order to beat out their rivals. Some entrants will be large national and international enterprises with the ability to draw on practices and expertise developed elsewhere.

Need for regulation

Most jurisdictions regulate the rates that automobile insurers can charge and their ability to meet their claims. The need for each of these types of regulation differs from one reform option to another.

Rate regulation

Currently ICBC faces a demanding regulatory process for approval of its rates. Each year it initially files a Revenue Requirements Application of more than 1,000 pages to the BC Public Utilities (BCPUC) Commission. For the 2019 review, it filed 16 additional documents in response to the Commission's and intervenors' questions. Intervenors

[11] See, for example, Insurance Hotline, which provides quotations for seven provinces: <<https://www.insurancehotline.com/renewal-reminder>>.

themselves filed over 25 documents stating their positions or requesting additional information from ICBC (BCUC, 2019). The Commission viewed ICBC's submissions favourably and accepted its rate requests every year between 2004 and 2013. In the years since the government's Directive IC2 imposed a cap on rate increases, the BCPUC rate rulings have fallen short of ICBC's requests

A move to a competitive market would reduce the need for the burdensome regulatory process that now applies to ICBC. While regulating rates is common in automobile insurance markets with many competitive suppliers, it is less burdensome in those markets where the competitive pressures from the presence of more insurers reduces the need for extensive rate regulation.

Ontario insurers, for example, submit their proposed rate changes together with actuarial data to the province's Financial Services Commission. The Commission reviews the data together with the:

insurer's assumptions about claim costs, expenses and investment income to ensure that ... the proposed rates are:

- ❖ rates are just and reasonable;
- ❖ not excessive; and
- ❖ not going to impair a company's financial solvency. (FSCO, 2019)

For the second quarter 2019, the Ontario regulator approved rate increases for individual private insurance companies that ranged from -1.20% to +20.04%, and with an average adjusted for market share of +1.99% (FSCO, 2019w).

Commercialization and transfer of ownership each retain the existing monopoly over automobile insurance and thus would require either an extensive form of rate regulation or a competitive bidding process with safeguards for customers on price and quality. Still, if the regulation option were chosen, the provincial government together with the BC Public Utilities Commission could work together to streamline the regulatory process currently faced by ICBC in order to reduce costs that ultimately fall on the shoulders of customers.

Prudential regulation

Prudential regulation protects the solvency of automobile insurers and other financial institutions so that they can meet the claims of their customers. The BC Financial

Services Authority serves as the prudential regulator for provincial insurers, while the federal Office of the Superintendent of Financial Institutions (OSFI) regulates federal insurers. Both use OSFI's capital standards. ICBC, however, is not covered by the either; instead, it meets standards determined by the provincial government.

Stringent prudential standards will be required under both commercialization and private monopoly ownership because a failure in either case would cripple the automobile-insurance market and require a government bailout to keep the insurer going. Failure of an insurer in a competitive market with multiple suppliers would be less serious; the financial effects would be smaller, depending upon the size of the insurer. The largest insurer in Ontario, for example, accounts for less than 12% of the province's auto-insurance market. If it failed, other insurers would rush to take over its business, providing continuity in the market.

Benefits to the government

Governments can benefit from the proceeds of the sale of assets such as crown corporations. Two of the options discussed above, commercialization and opening the market to competition, would not provide any benefit. With commercialization, the government would still retain ownership whereas opening the market to competition would not involve any sale of assets.

Features of alternative approaches to reform

Issue	Approach to Reform		
	Commercialization	Sale of ICBC	Competitive Insurance Market
Political			
<i>Possibility of government interference</i>	High	Moderate	Low
Benefits to customers			
<i>Lower cost of insurance</i> [1]	Moderate	Moderate	High
<i>Innovation</i>	Low	Uncertain	High
Benefit to government			
<i>Proceeds of sale</i>	None	Possible but small	None
Need for regulation			
<i>Rate</i>	High	High	Moderate
<i>Soundness</i>	High	High	Moderate

Note: [1] Compared to continuation of ICBC pre-reform policies.

The government could benefit from the sale of ICBC's assets to private interests to the extent that the assets had any value. The Corporation's equity share attributable to the provincial government was just \$119 million, principally unrecognized gains on financial assets (ICBC, 2019a). The Corporation's retained earnings at the end of last fiscal year summed to negative \$21 million. Private-sector interests, however, might be willing to pay to take over ICBC if they believed that they could generate a profit by running the auto-insurance business more efficiently.

Moving Forward

Assessment of the various options for reform shows that, on balance, opening the market to competition would provide the greatest benefits and thus should be the preferred choice in the long run. Introducing greater competition, however, requires overcoming a number of obstacles. Measures would have to be taken to deal with customers' fears arising from uncertainties about the reform. In addition, entrants into the market should have access to information on customers' driving records so they can assess the risks drivers pose.

The role of ICBC

ICBC should still have a role as a market competitor after the reforms. Interests opposed to reform have suggested that private insurers will charge higher rates than a publicly owned insurer. ICBC's presence would serve to counter this concern. If private insurers were unable to offer rates competitive with ICBC, customers would be able to direct their business to it and its lower rates.

For ICBC to continue as a meaningful competitor, changes need to be made to its mandate to remove the costs of its non-insurance activities. As a monopoly, ICBC benefitted to some degree from the road-safety programs but now, as all insurers will gain the benefits, ICBC should not foot the whole bill. Licensing costs also should not be borne by ICBC alone. Instead its licensing bureau should be converted to a stand-alone agency that establishes a relationship with brokers representing all insurers to maintain the current one-stop licensing and insurance arrangements.

By the same token, any advantages that ICBC gains from government ownership should also be eliminated. ICBC has been allowed to operate with capital levels well below those required of private insurers, indeed levels where private insurers would be put out of business. The government's role as a guarantor in effect subsidizes ICBC by allowing it to avoid the capital standards required of private insurers. Just as the present government legislated a prohibition on transfers from ICBC, it could place the insurer on a par with private insurers by making it meet the same capital standards. Such a move would have to be done gradually to avoid pricing ICBC out of the market and would also have to be done irrevocably to be assure the subsidy ends.

Legacy costs such as employee wages and leasing contracts may leave ICBC uncompetitive with its private competitors. In this case ICBC's market share will dwindle and reliance would have to be placed on competitive pressures to keep automobile-insurance rates as low as economically possible.

Need for information

While the market for optional insurance is been open to ICBC's competitors, the share of this sector held by the competitors has stalled at around 23%. [12] This modest share held by private insurers raises two questions. Why have private insurers had such a limited impact? And, if private insurers have had such a small impact on the optional market, why should there be any expectation that allowing private insurers into the basic insurance market would have a significant benefit for customers?

The limited presence of private insurers appears to be the result in part from their lack of access to the driving records of potential customers. By virtue of its monopoly over basic insurance, ICBC holds the records of all owners of insured vehicles, while its competitors for optional insurance do not have access to this information, which is vital for determining an insurer's risks. The private insurers' access to information together with other ICBC practices has been the subject of an inquiry by the Competition Bureau to determine the existence of abuse of dominance (Competition Bureau Canada, 2008). One criterion for such a case is whether the party to be investigated is engaged in anti-competitive behaviour. In particular, part of the complaint at issue here alleged that ICBC lessened competition in the optional insurance market by "prohibiting brokers from 'screen scraping' customer data from ICBC ... online data base for use in preparing quotes ... for optional insurance offered by private insurers" (Competition Bureau Canada, 2008). Here the Bureau judged ICBC's policies to be potentially exclusionary. The Bureau, however, ended up not pursuing the case further because the economic impact was judged to be small, given the limited size of the optional market at the time. This lack of access to information would create a more significant economic impact in the much larger basic insurance market.

Without driver performance records, competition in the optional insurance market and future competition in the basic insurance market are severely limited. The force of competition should be strengthened by requiring that drivers' records held by any insurer be available to all other insurers. This could be achieved by creating a central registry of the driving records and claims history of all insured drivers.

[12] Personal communication from Aaron Sutherland, Vice-President, Pacific, Insurance Bureau of Canada, via e-mail, June 3, 2019.

For some, sharing of customer information by ICBC may raise privacy concerns. Nevertheless, concerns about privacy have not prevented ICBC from sharing customer information with bailiff services, municipalities, vehicle-repair companies, parking-lot operators, and towing companies (OIPC-BC, 2017). In addition, other Canadian automobile insurers do provide such information to the General Insurance Statistical Agency (GISA, 2020).

No-Fault Insurance and Reform of ICBC

Does the adoption of no-fault insurance change the case for reforming ICBC. If no-fault insurance succeeds in reducing the cost of insurance, would increased competition still be needed in the market for basic insurance? Further, does no-fault insurance conflict with the operation of private insurers?

The adoption of no-fault insurance will not alter the case for reform of ICBC. Even though no-fault insurance may lower the cost of automobile insurance, the Corporation will remain government owned and still have a monopoly over basic insurance. It is these conditions, rather than the form of insurance, that leads the introduction of competition into the market to offer benefits.

Provincially-owned insurers in Canada all offer no-fault insurance. Nevertheless, public ownership is not necessary and all the features of no-fault insurance would be possible in a market with private insurers. Indeed, 15 US states now offer no-fault automobile insurance.

Conclusion

The deterioration of ICBC's business over time suggests that the Attorney General was right to describe the Corporation as a "dumpster fire". Its overall costs for automobile insurance were generally higher than in other provinces and its financial condition became unsustainable after two successive billion-dollar losses. Reform was and is clearly needed to turn things around.

Reform of ICBC could be achieved by commercialization, a transfer of ownership from the government to another party, or opening up the market to competition. Each of these approaches has a different consequence for the insurance market.

The current BC government has taken substantial steps to commercializing ICBC's operations that, over time, should improve the conditions in the auto-insurance market. Still, commercialization has its drawbacks. ICBC will maintain a monopoly over basic automobile insurance and all the benefits flowing from recent reforms could be quickly reversed by a future government concerned with its finances or facing pressures to keep insurance rates artificially low.

Transfer of ownership from the government to another party is the least attractive of the reform options. This would eliminate government ownership but a single organization dedicated to operating in the BC market would still be vulnerable to government interference. This approach also perpetuates the monopoly model for automobile insurance and would need to be subject to measures to prevent it from exploiting its position.

In the long-term, BC car owners and drivers would best be served by an opening of competition in the automobile-insurance market. This step would benefit owners by providing lower insurance rates and fostering more innovative services than the other alternatives. Moreover, competition among suppliers will reduce the need for regulation of rates. This approach is also the option most immune to the sort of government interference that ignited the dumpster fire. The Government's recent measures to stem the flow of red ink at ICBC should not be the end of reform. Opening the market to competition is the best way to benefit consumers and should be the next step.

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