Understanding Why Basic Auto Insurance Rates in BC Are So High

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Executive Summary

The finances of the Insurance Corporation of British Columbia (ICBC) are in sad state with an expected loss of over $1 billion for the current year. Its troubles can be traced to two government policies: the requirement that it transfer funds to the government and the imposition of a cap on rate increases. Drastic measures are needed to prevent ICBC from becoming insolvent.

The NDP government moved quickly after its election in 2017 to reverse ICBC's decline. In February 2018, it acted to limit claims for pain and suffering from minor accidents and moved disputes over some injury claims outside the courts to reduce legal expenses. In August 2018, it announced changes to shift more of the accident costs from safer drivers to those with poorer accident records.

These actions are welcome, but the government could have gone further. This publication addresses some features of ICBC's business that keep its costs high. First it focuses on the protections bundled into the required basic insurance package; it then examines ICBC's non-insurance activities; and finally, it considers the risks posed by drivers of different ages.

ICBC's basic insurance required for all motor vehicles registered in British Columbia includes third-party liability for injury costs and vehicle damage caused by insured drivers. It also includes so-called No Fault benefits paid to drivers and their passengers regardless of fault. Compulsory insurance can be justified because at-fault drivers can impose costs on others. No Fault insurance does not have the same justification because an unfavourable event without insurance does affect not third parties.

At present, many motorists are forced to pay for No Fault coverage from which they do not benefit. Homemakers, students, and retirees do not need wage loss protection. Drivers who already have medical insurance will not value this feature of ICBC's basic insurance. The No Fault coverages cost $71 for each personal policy, or more than 8% of ICBC's average premium.

ICBC also carries out non-insurance activities on behalf of the provincial government at no cost. These activities include programs for improving road safety together with testing and licensing for both vehicles and drivers. The $170-million expenses for these activities are borne entirely by ICBC and add $50 per policy, or over 6%, to the costs of basic coverage.

It is ICBC's policy to charge drivers the same rates regardless of their age. Yet, much evidence shows that the incidence of accidents differs markedly among drivers of different ages. The costs of personal injury and property damage caused by drivers from 16 to 20 years old are estimated to be $900 more than for average drivers. The costs for drivers between 21 and 34 are also higher. This rate structure requires safer drivers to pay higher premiums to subsidize riskier drivers. ICBC's plans to add $100 to its premiums for inexperienced drivers will reduce only a small portion of the differences in costs.

Customers may prefer the ICBC's current policies that fund activities beyond basic auto insurance; that provide larger than the minimal package of services; and that set its insurance rates without regard for age. But preferring policies is only one side of the coin. These policies have costs and customers are unlikely to be aware of these costs. The costs of coverage beyond the minimum are buried in a 1,000-page document; those of non-insurance activities can be found in an obscure note to ICBC's financial statements; and the loss experience of drivers of different ages does not appear to be public. If ICBC revealed this information, people could judge these policies for themselves and exert pressure if they felt changes were needed.

Introduction

The finances of the Insurance Corporation of British Columbia (ICBC), the sole supplier of mandatory insurance in the province, are in sad state. [1] ICBC realized a loss of $889 million in 2016/17 and anticipates a loss of $1.3 billion for 2017/18. The deterioration of ICBC's finances has been so severe that it has depleted its capital reserves below the regulatory minimum. ICBC's troubles can be traced to two government policies: the requirement that ICBC transfer funds to the government and government directive IC2 of 2013 that imposed a cap of 1.5% on ICBC's annual rate increases. Over the last seven years, ICBC transferred $1,050 billion to the provincial government while the ceiling on rate increases cost it $830 million in lost revenues from 2015 to 2017. Given ICBC's condition, drastic measures are needed to prevent it from becoming insolvent.

The NDP government acted quickly after its election in 2017 to reverse ICBC's decline by introducing sweeping changes to its coverage. In February 2018, the government announced a limit of $5,500 for pain and suffering caused by minor accidents, claims for which have risen on average from $5,004 in 2000 to over $16,499 in 2016. In addition, BC's Civil Resolution Tribunal rather than courts would deal with some disputes over some injury claims for the purpose of reducing its legal expenses. The government has estimated that the limits to pain and suffering claims together with other changes would reduce ICBC's costs by more than $1 billion per year (*BC Gov News*, 2018a). It must be recognized that these measures, while reducing ICBC's costs, do not reduce the insurance costs of drivers. Rather they reduce ICBC's costs by diluting the value of its insurance by cutting the benefits to accident victims. [2]

The provincial government announced in August 2018 further changes to ICBC's policies that are designed to shift more of the costs from safer drivers to drivers with poor accident records while remaining revenue neutral (*BC Gov News*, 2018b). The measures include higher rates for drivers with multiple accidents and for less experienced drivers. It is also proposed that rates more closely reflect the record of drivers rather than cars, so as to prevent poor drivers from avoiding higher rates by driving other people's

[1] This section is based on Chant, 2018.

[2] The government recognizes this dilution by announcing that drivers have an option to buy additional coverage for pain and suffering (*BC Gov News*, 2018a).

vehicles. Together, the government expects these changes to lower rates by up to $50 for 39% of drivers, by between $50 and $100 for 15% of drivers, and by more than $100 for 13% of drivers in the province.

These government's actions are welcome. They shift costs to drivers with poor driving records and limited driving experience and they plug loopholes through which drivers could escape the consequences of their poor driving. But the government could have gone much further. The proposed changes overlook some features of ICBC's business that keep its rates for basic insurance high.

This paper addresses some reasons that ICBC's costs are high. It first focuses on the protections bundled into the basic insurance required of all BC vehicle owners. It then examines the costs of ICBC's non-insurance activities. Finally, it considers the risks posed by drivers of different ages to illustrate how they differ.

ICBC's Compulsory Coverage

ICBC has a monopoly in offering basic insurance, a package of coverage that is required for all motor vehicles registered in British Columbia. Basic insurance includes third-party liability for injury costs and vehicle damage caused by drivers of the insured vehicle. It also includes so-called No Fault benefits to drivers and their passengers in addition to third-party liability. [3] Unlike third-party liability, these benefits are paid regardless of fault and include medical and rehabilitation expenses and wage loss protection together with burial, funeral expenses, and other death benefits.

Overall, the basic coverage for BC motorists is in line with that offered by the majority of provinces (Devlin, 2017). Being comparable with other provinces does not mean that BC's present basic coverage should be compulsory for all motorists. Requiring all vehicles to be insured is common for automobile insurance, but it is less common for other types of insurance to be compulsory. There is no legal requirement in Canada for people to have life insurance, disability insurance, or theft insurance. Similarly, fire insurance, earthquake insurance, and insurance against flood damage are not legally required for homeowners, though they may be a condition for obtaining a mortgage. Why then is auto insurance compulsory for car owners? Further, what insurance coverage, if any, should be compulsory?

The argument for compulsory insurance arises because drivers can impose costs on others from accidents where they are at fault. Some form of compulsory third-party auto insurance then is needed to protect motorists, passengers, and pedestrians from the costs of damages caused by others. Without third-party liability for all vehicles, victims would suffer losses when the driver causing the accident is unable to compensate them for their losses. The argument for compulsory coverage may also justify coverage for damages caused by uninsured and unknown motorists. With compulsory third-party liability for all drivers, motorists have a reasonable expectation that others will have third party liability insurance. Uninsured and unknown insurance coverage protects victims when such expectations are not satisfied.

[3] No Fault insurance is provided under Part 7—Accident Benefits of the Insurance (Vehicle) Regulation, *Insurance (Vehicle) Act* (British Columbia, 2018b).

Coverage under Part 7 of the Insurance (Vehicle) Regulation does not have the same justification. As with other types of insurance, an unfavorable event without insurance affects only the individuals themselves. For these types of insurance, individuals can be left to weigh the risks of being uninsured against the benefits of having insurance.

At present, some insured parties are forced to pay for coverage under Part 7 from which they cannot benefit. Homemakers, students, and retirees will not benefit from wage loss protection. Similarly, since ICBC deals only with those costs not covered by other insurers, this feature means it will compensate only for those medical and rehabilitation expenses above and beyond those that are not payable through the victim's own medical insurance. Many of these expenses will already be covered BC medical insurance and, for some drivers, their private medical insurance. Those who already have medical insurance thus will not value this feature of ICBC's basic insurance.

Still, some motorists may value the benefits of Part 7 coverage and should have the opportunity to purchase optional insurance beyond basic coverage to protect themselves against these perils. Were this coverage to become optional, they may be able to gain coverage on more favourable terms from the private insurance companies that compete with ICBC for optional insurance.

Reducing the scope of basic coverage would allow motorists to tailor their insurance more closely to their needs and avoid features from which they do not benefit. If the scope of basic insurance were reduced, ICBC's rates for this coverage could be cut to reflect the resulting reduction in its costs. ICBC's actuaries estimate that the additional Part-7 coverage beyond third-party liability costs $71 for each insured vehicle, or 8.4% of ICBC's average $840 annual premium (ICBC, 2017a: Technical Appendix B.1.3).

Non-Insurance Activities

ICBC carries out, on behalf of the provincial government, a variety of non-insurance activities such as financing programs for improving road safety and administering testing and licensing for both vehicles and drivers. [4] The expenses of these activities are borne entirely by ICBC.

Like public insurers in Manitoba and Saskatchewan, ICBC undertakes road safety initiatives to reduce the losses from automobile crashes in the province. These initiatives range from education programs to providing financial support for municipalities making road improvements. For the 2016/17 fiscal year, these expenditures were approximately $50 million. [5]

The provincial government also makes ICBC responsible for conducting driver testing, driver and vehicle licensing, and collection of fines. The public insurers in Manitoba and Saskatchewan also carry out these activities for their governments. All the revenues collected by ICBC from these activities, most recently $712 million annually, are transferred to the provincial government. The auto insurer in Manitoba also transfers licensing revenues to the provincial government, but it receives funding from the government to defray the costs of these activities (Mantoba Public Insurance, 2018). In contrast, ICBC receives no such funding and bears an annual cost of over $125 million for driver testing, driver and vehicle licensing, and the collection of fines (ICBC, 2017b: 7).

The combined non-insurance activities of road safety and licensing add $150 million per year to ICBC's costs and are charged against ICBC's basic business. In total, these non-insurance activities add $44 per policy, or over 5%, to the costs of ICBC's basic coverage.

[4] See note 17 to the Consolidated Statement of Comprehensive Loss in ICBC, 2017b.

[5] Throughout the study, all amounts for the fifteen-month fiscal year 2016/17 are adjusted to correspond to a calendar year.

ICBC's Rate Structure

ICBC makes the claim that it offers "open and fair rate setting" (ICBC, 2018). By this it means that drivers pay the same rates regardless of their age, sex, and marital status. The approach differs from most other auto insurers in Canada, whose rates are based on age and gender because of differences in accident experience.

ICBC does not make information available about the incidence of accidents by different groups of drivers. In the absence of BC data, US data (NHTSA, 2017) have been used to proxy the BC. experience. [6] [7] The differences in driver risk groups are used to estimate the damage costs incurred per driver.

ICBC reported in its 2017 Revenue Application to the BC Utilities Commission (ICBC, 2017a) that the cost of property damage was $3,555 for each accident, which gives an estimated average claim for property damage of $124 for drivers overall (**table 1**). [8] For drivers 16 to 20 years old, the $286 average cost of property damage per driver is $162 higher, more than 2.3 times that for the average driver and over 4.8 times that for the lowest risk group. The costs of property damage per driver for the 21-to-24 and 25-to-34 age groups are also higher than for the average driver, though by smaller amounts. The costs of property damage are smaller on average for all drivers older than 45.

The same pattern of driver involvement also applies to accidents causing personal injury (**table 1**). While the involvement rates for personal injury are roughly the same as for property damage, the $44,447 cost per accident is more than 10 times higher. The $1,417 average cost per driver of personal injury accidents for the youngest group exceeds the

[6] Estimates for British Columbia based on the US experience may be subject to error for a variety of reasons. They would likely be biased upward to the extent that BC's graduated driving program has made younger drivers safer (Sayed and Sacchi, 2015). On the other hand, estimates would likely be biased downward because risky drivers aged 16 to 20 account for a 24% larger share of drivers in British Columbia than in the United States.

[7] Saskatchewan also provides data on accident experience by age group. The accident rates for Saskatchewan are overall less than for the United States. Using these accident rates leads in both cases to estimates of claim expenses well below ICBC's experience. The US data have been used because they provide estimates closer to ICBC's costs.

[8] This estimate is based on ICBC's average accident cost for property damage applied to the National Highway Traffic Safety Administration's statistics for driver involvement (NHTSA, 2017).

Table 1: Estimated ICBC accident costs ($) by policy-holder age group, 2017

Age group	Cost of property damage per policy	Difference from average cost of property damage accidents	Cost of personal injury per policy	Difference from average cost of personal injury accidents	Excess above average ICBC accident costs by age group
16–20	$286	$162	$1,417	$771	$833
21–24	$210	$87	$1,092	$446	$535
25–34	$146	$22	$792	$145	$167
35–44	$124	$1	$657	$(11)	$(12)
44–54	$84	$(40)	$548	$(98)	$(138)
55–64	$87	$(36)	$455	$(192)	$(228)
65–74	$67	$(56)	$358	$(187)	$(243)
>74	$59	$(57)	$329	$(317)	$(374)
Average	**$124**		**$646**		

Notes: [1] Parentheses indicate less than average. [2] Estimation method: Property crash involvement rates by age group from the US study were applied to ICBC property damage (personal injury) costs per accident to give estimated property (personal injury) costs per driver by age group.

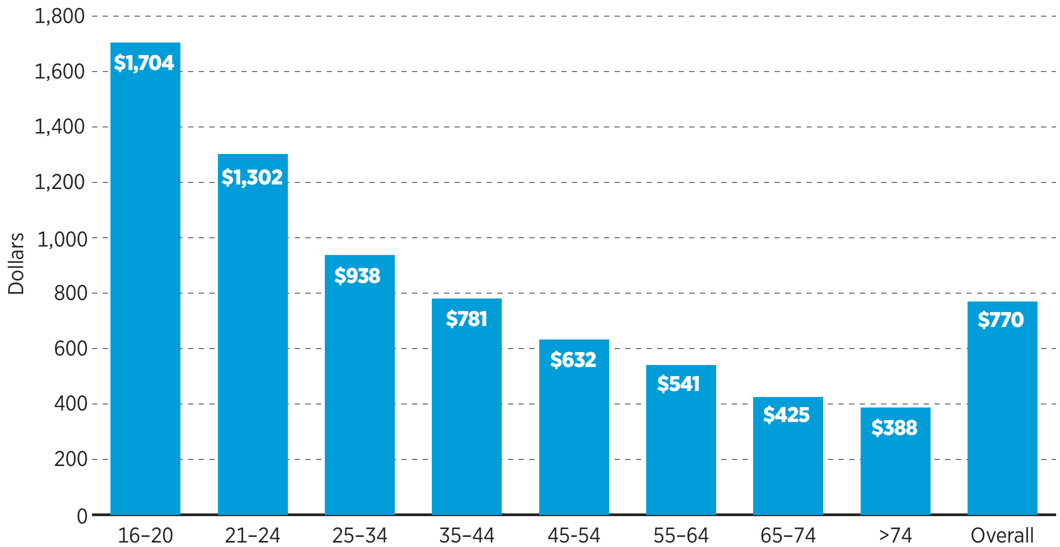
Sources: ICBC, 2017c: Quick Statistics; NHTSA, 2017.

costs of the average driver by $771 and is more than $1,000 higher than the cost for the lowest risk group. Like property damage costs, the personal injury costs for drivers over 45 are all below the average.

Figure 1 shows the substantial difference in the total costs of personal injury and property damage costs per driver by age group. The $1,703 cost for drivers 16 to 20 years old exceeds the average cost for other drivers by $934 and is more than $1,300 higher than for drivers over 74. Similarly, the costs for 21-to-24 year olds exceed that of the average driver by $532 and, for 25-to-34 year olds, by $168.

ICBC's current rate structure requires safer groups of drivers to pay higher premiums to cover the costs of riskier drivers. In effect, safer drivers subsidize the premiums of others by substantial amounts. While these subsidies do lead to lower premiums for some drivers, they push up basic insurance costs for low-risk groups. Drivers over 65

Figure 1: Estimated ICBC accident costs ($) by policy holder age group, 2017



Source: Table 1.

are shielded from the subsidy costs somewhat due to their 25% discount. Our estimates suggest the subsidy for younger drivers raises the insurance costs by more than $138 for drivers aged 45 to 54, and by $228 for those aged 55 to 64.

With the announced changes to its rates, ICBC now plans to add $100 to the annual cost of insurance premiums for drivers with less than 10 years of experience. This measure will reduce only a small share of the differences in costs incurred by higher risk drivers.

Conclusion

Successive BC governments have used the Insurance Corporation of British Columbia as an instrument of government policy to fund activities that go beyond auto insurance. ICBC customers may prefer a larger package of services than that provided by a minimum coverage. They may welcome ICBC funding road safety initiatives and be happy with ICBC providing licensing and testing services at no charge to the government. They may also agree with ICBC's policy of setting its insurance rates without regard for the age and sex of the insured.

But preferring policies is only one side of the coin. These policies come at a cost. And are they worth the costs? Currently, customers are unaware of these costs. It is an open question whether customers would still prefer these policies if they knew the true costs.

It costs ICBC's personal customers $71 a year for the Section-7 coverage, which many may not need nor want. It costs them another $44 for safety programs and ICBC's expenses for testing and licensing. These amounts correspond to 14% of the cost of a minimum basic insurance coverage. To put these costs in perspective, they are larger than the savings for the vast majority of customers resulting from ICBC's recent proposals to adjust rates. And, unlike the ICBC proposals that offer savings only to the safest drivers, these savings could be offered to all insured car owners.

The fact that ICBC's rates are set without regard for age and sex affects drivers in different ways. All drivers younger than 35 years old benefit from this policy. Drivers in the 16-to-20 year age group pay rates that are roughly $900 lower than would be the case if rates were based on their group's accident experience. At the same time, drivers older than 45 on average pay higher insurance premiums than warranted by their estimated accident rates. In the most extreme case, drivers over age 74 pay $374 more per year more than they would with experience-rated insurance pricing.

The government could have provided this subsidy to riskier drivers directly through its budget, but that would have required the government to spend over $300 million during 2016/17. It is unlikely that such a measure would meet with general public favour. Instead, achieving this goal indirectly through ICBC meant safer driver groups paid $236 more for their basic insurance than they would have otherwise.

ICBC customers are unlikely to know how much these practices cost them. The costs of coverage beyond the minimum are buried in the midst of a 1,000-page document; [9] the costs of non-insurance activities can be found only in a note to ICBC's financial statements; [10] and information on the loss experience of drivers of different ages does not appear to be in the public domain at all.

This study does not try to guess how drivers would view the effects of ICBC's policies if they knew their real costs. ICBC, however, fails to make the needed information available. If it did, the public could judge these policies for themselves and exert pressure for change where they felt it was needed. In any case, this study shows there is plenty of room for reducing the cost of basic insurance below what it would be under ICBC's current practices.

[9] Readers would have to turn to Technical Appendix B.1.3., Restatement of Appendix B.1.3. from PY 2016 RRA on a Fiscal Year Basis, Fiscal Year Average Written Premium at Current Rate Level in *ICBC Revenue Requirements* (ICBC, 2017a), among other equally obscure places, to find reference to Part 7 costs.

[10] This information can be found in Note 17 to the Consolidated Statement of Comprehensive Loss in ICBC's *Statements and Schedules of Financial Information* (ICBC, 2017b).

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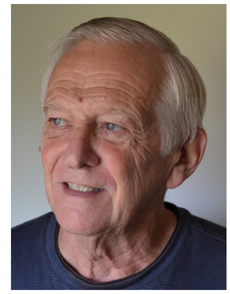

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