OCCASIONAL PAPER No. 39 ICBC

SOME OBSERVATIONS ON ICBC'S 2016/17 ANNUAL REPORT

Recently the government released the 2016/17 Public Accounts, and the annual reports of ICBC and BC Hydro. This paper provides my general observations on the 2016/17 results for ICBC.[1]

DELAYED RELEASE

The ministry of finance seems to have adopted a policy of releasing the ICBC and BC Hydro annual reports in conjunction with the release of the government's audited public accounts. This delay appears unnecessarily as the financial statements of the two Crown corporations have already been reviewed and certified by ICBC's and BC Hydro's external auditors.

The convention of revenue budget secrecy has been extended to encompass the expenditure budget. Tt now seems that the same rationale is being used to delay the release of financial information for a fiscal period that ended months after the release date.

ACCOUNTABILITY ERODED BY THE FISCAL YEAR CHANGE

ICBC had been operating on a January to December fiscal year since its inception in 1974. In the spring of 2016 the Liberal government changed the *Insurance Corporation Act* to require ICBC to conform to the government April to March reporting standard. Therefore, the 2016/17 annual report is a bridge year spanning the 15 months from January 2016 to March 2017.

To preserve the 40-plus years of data continuity, ICBC should have provided separate financial and operational data for 2016 and the bridge quarter in 2017. Instead, ICBC management deliberately chose to report only the 15-month information. The Saskatchewan Government Insurance corporation made the same fiscal year change last year, but it provided comparative 12-month information.[2]

The lack of comparable financial and claim data is highly regrettable and should be corrected. The public is now forced to make highly questionable assumptions as to the actual 2016 results to attempt to develop trend information. The 15-month data includes

[1] http://www.icbc.com/about-icbc/company-info/Documents/ar-2017.pdf
[2] https://www.sgi.sk.ca/pdf/annualreports/SGI_2016_Annual_Full.pdf

the abnormally large number of claims registered during the prolonged icy road conditions experienced in the lower mainland and greater Victoria in January and February of 2017.

Given ICBC's previous reluctance to provide comparative financial and claim information (let alone any meaningful analysis) at the program level, this latest development reflects a defensive and secretive management culture.

If not corrected, the 2017/18 annual report will report on a 12-month basis, with the comparative information being the 15-month 2016/17 year, thereby losing a second year of trend data.

Given that the government has established ICBC as the monopoly supplier of Basic auto insurance, it is incumbent on the corporation to operate at the highest standard of transparency and accountability. Its reports must ensure full accountability for the $3.6 billion in policyholders' premium payments. The current opaque reporting falls well below such a standard.

On 25 August 2017, I wrote to Auditor General Bellringer to ask whether ICBC's annual report conforms to her Office's standards as to acceptable public accountability and transparency (see Appendix). I await her response.

CORPORATE VERSUS PROGRAM INFORMATION

In keeping with previous reports, practically all the comparative information and explanation is at the corporate level. This is another failing because the Basic and Optional programs are distinct, and have separate regulated minimum capital requirements. The Basic program is, in theory, regulated by the BC Utilities Commission which reviews and approves annual rate changes and the management target for the capital reserve.

The claims and financial information must be at the program level if the reader is to form any meaningful understanding of the information, and the change in the capital reserves.

Perhaps the new government will force ICBC to produce more informative annual and quarterly reports (the current one page highly simplified quarterly report is simply laughable when compared to the reports from BC Hydro, WorkSafe BC or the two other public auto insurers).

THE 2016/17 RESULTS

The 15 months ending 31 March 2017 witnessed a massive increase in claims costs, which far outstripped the growth in combined revenue and investment income. Table 1 shows the change in the combined premium and fee revenue and the investment income, compared to the change in the total of incurred current claims and the adjustment to the estimate for claims in prior years.

TABLE 1 – CHANGE IN REVENUE AND CLAIMS COSTS ($=million)

	------------BASIC-----------				--------OPTIONAL----------			
	16/17	**2015**	**Change**	**%**	**16/17**	**2015**	**Change**	**%**
Rev&Inv Inc	4,096	3,321	775	23.3	2,700	2,141	559	26.1
Claims Cost	3,856	2,858	998	39.9	2,110	1.184	926	78.2
Net Income	(581)	(267)	(314)		(331)	387	(718)	

Note: Excludes the $201 million net income transfer from Optional to Basic to provide a more realistic view of results.

The major reason for the increase in the Basic operating loss was the increase in claims (current and prior years). The same observation is more obvious in the Optional program, where claims costs (over 15-months) increased dramatically compared to 2015.

The $926 million increase in the Optional claims includes a $312 additional provision for prior years claims costs; presumably to account for higher actual settlement severities (average cost of settled claims compared to the original forecast).

CAPITAL RESERVE (EQUITY)

The size of the capital reserve is the key to understanding the rapid deterioration in ICBC’s financial health. Most private property and casualty insurers in Canada must adhere to the federal regulator’s capital ratio targets to ensure that sufficient assets are available to pay claims in the event of unexpected adverse events.

The provincial government adopted the federal capital ratio guidelines and established a minimum risk-weighted asset to liability ratio of 100% and 200% respectively for the Basic and Optional programs in the early 2000’s. If liabilities grow, this minimum capital test (MCT) ratio formula requires that assets must increase at a greater level to maintain the same ratio. This puts pressure on the premium rate.

Due to the structural funding deficit in the Basic program, and the large profits generated by the sale of Optional policies (to the same vehicle owners), the government has ordered the transfer of Optional capital reserve and (in 2016) operating income to subsidize the lower than required Basic rates.

Table 3 shows the 2015 year-end capital reserves and ratios for both programs. The Optional transfers for 2016 adjust the opening balances, and the losses for the 15-month period result in lower 31 March 2017 positions.

TABLE 3 – CHANGE IN CAPITAL FOR 2016/17 ($=million)

		BASIC	RATIO	OPTIONAL	RATIO
	31 Dec. 2015 Position	1,071	83	2,075	300
	From Optional -Capital	450		(450)	
	-Capital	172		(172)	
	-Net Income	201		(201)	
	Adjusted Start Point	1,694	133	1,252	181
	2016/17 (15-month) Loss	(238)		(262)	
	31 March 2017 Position	1,456	103	990	130

By 31 March 2017, the government-ordered transfers of the Optional policyholders' capital reserves ensured that the Basic ratio remained above the 100% regulatory requirement. However, the now weakened Optional reserve was some 70 basis points, or approximately $500 million, below the minimum 200% regulatory requirement.[3]

Not surprisingly, ICBC has not issued a first quarter (April to June) report to determine if the capital deterioration is continuing at the same pace for the current year.

A more realistic view of the capital losses for the two programs during the last 27 months is shown in Table 4, where the various Optional transfers to Basic insurance have been excluded.

TABLE 4 -- NORMALIZED 27 MONTH CAPITAL LOSS ($=million)

		BASIC	RATIO	OPTIONAL	RATIO
	31 December 2014	1,633	136	1,983	298
	2015 Result	(562)		230	
	Excess to Province	--		(138)	
	31 December 2015	1,071	83	2,075	300
	2016/17 Result	(438)		(262)	
	31 March 2017	633	46	1,813	252

Source: ICBC annual reports with derived MCT ratios.

This view shows the structural deficit in the Basic program, which is partially masked by the transfers from the Optional program in the published financial reports. Excluding the transfers, during the 27 months the Basic capital dropped by $1.0 billion, while the

[3] I have argued that, because of ICBC's market share, the 200% regulatory minimum is too conservative and could be reduced.

Optional capital declined by $180 million, and most of the decline was the “excess” capital transfer to the government in 2015.

IMPLICATION FOR FUTURE RATE INCREASES

It is probable that had a major private sector insurer experienced such a rapid capital loss the federal regulator would be considering seizing control of the company to protect current and future claimants.

The previous government was certainly aware of the negative trends in ICBC’s financial condition, but it chose to continue with the destructive practice of depleting the policyholders’ capital reserve to subsidize Basic rates. It also ordered an independent review of the Basic program to defer public discussion of the financial deterioration until after the 2017 election.

If the current growth trend in claims costs continues ICBC must either seek additional equity from the taxpayer, reduce the coverage benefits or dramatically increase the Basic (and possibly the Optional) premium. The likely increase needed to rebuild and maintain the capital reserves at the regulatory minimum levels will be well significantly higher than the 30% suggested in the Ernst Young report.[4]

ICBC has some ability to encourage safer driving through the penalty point system, but most remedial measures require the active leadership and direction of the provincial government.

Such measures will be discussed in a future paper.

 http://www.bcpolicyperspectives.com/

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[4] Ernst Young optimistically suggested that an average 30% increase over two years would be required to achieve a 145% ratio for the Basic program, see http://vancouversun.com/news/politics/huge-icbc-rate-hikes-loom-unless-drastic-reforms-happen-fast-report-warns

APPENDIX--EMAIL TO AUDITOR GENERAL C. BELLRINGER August 25, 2017.

Ms. Bellringer:

ICBC's 2016/17 annual report and audited financial statements are now finally public.

As you know, the 2016/17 report contains financial and operational information for a 15-month bridge year, as the previous government, through Bill 10 – Budget Measures Implementation Act, 2016, changed ICBC's fiscal year from January to December to April to March.

The obvious danger in such a change is the loss of comparative 12-month information which can be used for trend analysis, unit costing and other purposes. This concern was expressed by Mr. Dix on March 9, 2016 during the debate on Bill 10. A key part of the exchange with the Minister of Finance is produced below:

A. Dix: In my understanding, there's the accident year, which will now be different from the fiscal year and is now different from the policy year. So while this has the effect, as I understand it, of aligning ICBC with other government agencies, it makes ICBC less aligned, shall we say, with itself. If you look at fiscal comparators dating back since the beginning of the ICBC…. Since the beginning of ICBC, the accident year and the fiscal year start January 1, as I understand it, and go through to December 31.

Is it ICBC's intention, for comparative reasons…? It goes through routine BCUC processes on the basic side. The government covers up the optional side from such scrutiny, and we may be talking about that in a few minutes. But on the basic side, will ICBC be at least going back a number of years so that there can be a baseline for people to compare fiscal years and performance?

Hon. M. de Jong: I think I was anticipating a particular question, and the member's was slightly different. I think the question was this. In making this adjustment, is the member asking whether there will, in effect, be a form of restatement of the reporting out so that there can be an apples-to-apples comparison?

The member is indicating that that is….

Interjection.

Hon. M. de Jong: Going backwards. I'm going to check…. My guess is, but I'm going to confirm, for analysis purposes, that that may well be the case. I'm not sure there's a plan to restate annual reports, but I'll make that inquiry.

The minister noted that the answer was to provide both a 12-month as well as the 15-month information to allow reconciliation to prior fiscal years. In fact, this is normal practice. The Saskatchewan public insurance provider also changed to the April to March reporting period last year, but the annual report for the Auto Fund provided both sets of financial and operational data.

I would also note that the January to March 2017 quarter included in the current report was an abnormally heavy claims period because of the prolonged icy road conditions in the main population centres.

It the current report is not amended it is probable that the report for 2017/18 will result in a disruption of the comparative information for a second year, as the comparison of the 12-month 2017/18 period will be to the 15-month 2016/17 prior period.

Do you believe that ICBC's 2016/17 annual report and financial statements meets expectations for proper accountability and transparency? Do you intend to ask the corporation to re-file the 2016/17 annual report with the 12-month information (especially the program level financial information on page 97) included?

Sincerely,

Richard McCandless