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NEW REPORTS CONFIRM ICBC'S CAPITAL LOSS CONTINUES: FINANCE MINISTER CAROLE JAMES HAS GRAVE CONCERNS

In a recent interview, finance minister Carole James expressed "real worry" about how the precarious finances of BC Hydro and ICBC threatens the new government's three-year fiscal plan.[1]

The previous government's policy of underpricing ICBC's compulsory Basic insurance rates resulted in the Optional capital reserve falling below the government's regulatory minimum level by 31 March 2017 (see Appendix).[2] The rate suppression has continued for the 2017 policy year, where ICBC estimated that a 20% increase in Basic rates was required. However, the NDP government approved a 6.4% increase,[3] and ordered a further infusion of $470 million of Optional capital to cover the resulting deficit in Basic capital.

The government has contracted with Chris Trumpy, a former deputy minister of finance, to undertake a "fiscal sustainability review" of ICBC and the other major Crown corporations. The purpose of the review is to assess the risks, finances and fiscal forecasts of the major public agencies.[4]

What will ICBC's capital reserve forecast reveal about the future financial condition of our public auto insurer?

FORECASTING FUTURE CAPITAL LEVELS

Unfortunately, ICBC does not publicly release forecasts of the Basic and Optional revenue and expenditures, or the capital reserves. The revised 2017/18 service plan (released on September 5th) does provide a three-year forecast of ICBC's revenue and expenditures and the capital (equity) reserve, but only at the corporate view; key assumptions as to changes in rates, claims or other key variables were excluded.[5]

I have attempted to develop a three-year capital forecast based on the limited information provided by ICBC. The updated 2017/18 Service Plan provides ICBC's

[1] Voice of BC, October 6, 2017; https://vimeo.com/237111119

[2] From 2012 to 2016/17, approximately $1.3 billion in Optional capital was transferred to keep the Basic capital ratio above the regulatory minimum.

[3] This was the maximum allowed under the 2013 "rate smoothing" regulation. Optional rates will rise 9.6% on an annualized basis. By comparison, the public auto insurer in Manitoba is seeking a 2.7% increase in Basic rates for the 2018 year, while the Saskatchewan compulsory program is not seeking a rate increase.

[4] http://www.timescolonist.com/opinion/columnists/les-leyne-outside-review-eyes-housing-agency-1.23047982

[5] http://www.icbc.com/about-icbc/company-info/Documents/Service-Plan-201718-201920-updated-Sept2017.pdf

three-year forecast for the combined capital, but did not provide the MCT ratio, as shown in Table 1.

TABLE 1 -- WHAT THE 2017/18 UPDATED SERVICE PLAN SAYS ($=million)

	2016/17	Ratio	2017/18	Ratio	2018/19	Ratio	2019/20	Ratio
BASIC								
OPTIONAL								
COMBINED	2,446	112	2,030	TBD	1,809	TBD	1,520	TBD
MCT Factor								
Basic 1%=								
Optional 1%=								
Combined	21.8							

Source: ICBC 2017/18 to 2019/20 Service Plan (Updated). September 2017.

The 2016/17 annual report also adds some detail on the Basic and Optional capital position, as of 31 March 2017.[6] The annual report does not provide future year forecasts, nor any serious analysis as to why claims costs increased dramatically during the 15-month 2016/17 bridge year, compared to the calendar year 2015.[7]

TABLE 2 -- WHAT THE 2016/17 ANNUAL REPORT ADDS ($=million)

	2016/17	Ratio	2017/18	Ratio	2018/19	Ratio	2019/20	Ratio
BASIC	1,456	103						
OPTIONAL	990							
COMBINED	2,446	112	2,030	TBD	1,809	TBD	1,520	TBD
MCT Factor								
Basic 1%=	14.1							
Optional 1%=								
Combined	21.8							

Source: ICBC 2017/18 to 2019/20 Service Plan (Updated). September 2017; 2016/17 Annual Report.

The Basic rate request for 2017, filed with the BC Utilities Commission on 15 September 2017, added the capital and ratio forecast to 31 March 2018. ICBC, unlike the public auto insurers of Saskatchewan and Manitoba, does not provide multi-year forecasts for the Basic insurance as part of its extraordinarily large amount of detailed data provided in the 1,100-page submission.

The 2017 rate request states that the Basic capital ratio is forecast to be 101% by 31 March 2018, after a transfer of $470 million from the Optional program. The 1% capital ratio factor of $14.4 million is derived from the year-end capital divided by the 101% ratio.

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[6] http://www.icbc.com/about-icbc/company-info/Documents/ar-2017.pdf p. 97.

[7] The government changed ICBC's January to December fiscal year to match the government's April to March reporting period. The 2016/17 report includes the 15-month results from January 2016 to March 2017, but comparable 12-month results were, unfortunately, not provided.

Table 3 shows the 2017/18 Optional capital as a simple subtraction of the combined service plan forecast less the Basic 2017/18 forecast contained in the 2017 Basic rate request. The Optional 31 March 2018 value is the difference between the service plan and the Basic rate application.

TABLE 3 – ADDING THE 2017 RATE REQUEST INFORMATION ($=million)

	2016/17	Ratio	2017/18	Ratio	2018/19	Ratio	2019/20	Ratio
BASIC	1,456	103	1,485	101				
OPTIONAL	990	138	545	73				
COMBINED	2,446	112	2,030	88	1,809	TBD	1,520	TBD
MCT Factor								
Basic 1%=	14.1		14.4					
Optional 1%=	7.2		7.5					
Combined	21.8		23.1					

Source: ICBC 2017/18 to 2019/20 Service Plan (Updated). September 2017; 2016/17 Annual Report; ICBC 2017 Rate Request Application, September 15, 2017. The Optional capital ratios are my estimates based on projecting the ratios from 2013 to 2015.

Finally, to forecast the Basic and Optional capital for 31 March 2019 and 2020, the service plan capital reductions in 2019 and 2010 were attributed to the Basic program, while the Optional capital showed some gain. The capital ratio factor was escalated for both Basic and Optional based on the trends from prior years, factoring the steady loss of equity. This forecast assumes no additional Optional transfers to the Basic program.

TABLE 4 -- ESTIMATED THREE-YEAR CAPITAL POSITION ($=million)

	2016/17	Ratio	2017/18	Ratio	2018/19	Ratio	2019/20	Ratio
BASIC	1,456	103	1,485	101	1,239	80	930	58
OPTIONAL	990	138	545	73	570	73	590	71
COMBINED	2,446	112	2.030	88	1,809	75	1,520	61
MCT Factor								
Basic 1%=	14.1		14.7		15.4		15.9	
Optional 1%=	7.2		7.5		7.8		8.3	
Combined	21.8		23.1		24.1		25.1	

Source: ICBC 2017/18 to 2019/20 Service Plan (Updated). September 2017; 2016/17 Annual Report; ICBC 2017 Rate Request Application, September 15, 2017.

The forecast in Table 4 shows that by 31 March 2018, after the $470 addition from the Optional program, ICBC forecasts that the Basic capital ratio at 101%, or at the minimum regulatory level. The Optional capital will fall to $545 million, a ratio of only about 73%.

By 31 March 2020, the Basic capital will fall to $930 million, while the Optional hovers near $600 million. In this scenario, ICBC forecasts that the Basic program will have lost some $526 million from 2017 to 2020.

ICBC's service plan forecast did not disclose the future year Basic and Optional rate increase assumptions used to develop the combined capital of $1.52 billion by 31 March 2020. The combined earned premium revenue rises 29%, but this includes an increase in policies, offset by a decline in the average revenue per policy. Assuming 20% of the increase is due to rates rising over the three years, one must then make assumptions about the rate increases between Basic and Optional.[8]

INCREASING REGULATORY CAPITAL DEFICITS

The longer the structural deficit in the Basic program remains, the greater capital loss and the greater the gap between the actual capital and the amount required to meet the government's 100% regulatory minimum level.

Table 5 is the inverse of Table 4, where the actual forecast capital is compared to the minimum required for Basic (at 100%) and Optional (at 200%)., assuming no further Optional transfers to inflate the Basic capital.

TABLE 5 -- SHORTFALL TO REGULATORY MINIMUM CAPITAL ($=MILLION)

	2016/17	Ratio	2017/18	Ratio	2018/19	Ratio	2019/20	Ratio
BASIC	46	3	45	1	(308)	(20)	(670)	(42)
OPTIONAL	(450)	(62)	(955)	(127)	(990)	(127)	(1,070)	(129)
COMBINED	(404)		(910)		(1,298)		(1,710)	.
MCT Factor								
Basic 1% =	14.1		14.4		15.4		15.9	
Optional 1% =	7.2		7.5		7.8		8.3	
Combined 1%	21.8		23.1		24.1		25.1	

The key to this forecast is the annual capital ratio factor; for example, the Basic rises from $14.4 million for 1% in 2017/18 to $15.9 million in 2019/20. The lower the factor the lower the deficit to the regulatory minimum.

Table 5 shows that on 31 March 2017 the Optional capital (at 138%) was in deficit by $450 million, while the Basic ended the year with a slight surplus. By 31 March 2020, the Basic capital is forecast to be in deficit by $670 million, while the Optional deficit will have grown to $1.07 billion. Combined, ICBC's capital deficit is forecast to be approximately $1.7 billion.

The new provincial government and the board at ICBC have difficult decisions to make regarding the rate increases and coverage levels of the compulsory Basic insurance. The 2017 rate increases of 6.4% for Basic, and an annualized 9.6% for Optional insurance, have already been incorporated into these forecasts. ICBC has added further (unknown)

[8] I did not attempt to estimate the Basic and Optional rate increases used.

rate and volume increases to develop the 2017/18 updated service plan, yet the reserve deficit continues to grow.

To return the Basic capital ratio to 100% will require a massive 2018 annualized rate increase of approximately 10%,[9] in addition to the unknown rate increase incorporated in the service plan forecast. If the increase is postponed until 2019, an annualized increase of about 22% would be necessary.[10] To restore the Optional capital to the minimum 200% ratio by 31 March 2018 would require a massive (but one-time) increase to the Optional rates.[11]

The NDP government has promised to keep ICBC affordable. Clearly, given the forecast growth in the capital reserve deficits, some reductions to coverage levels (and the government paying for free services from ICBC),[12] will be required to restore ICBC to a healthy financial condition over a period of years.

These indicated rate increases for Basic and Optional are far larger than the combined 30% increase by 2019, as suggested by the Ernst Young report.[13]

Little wonder that finance minister James has grave concerns about the fiscal stability of our public auto insurer.

 October 11, 2017. 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 ICBC's rate requests, and is an intervener in the Commission's current review BC Hydro's rate request.

[9] To achieve the 100% ratio by 31 March 2019 would require almost 25%, but 10% annualized over the year.
[10] For 2017, a 1% increase in Basic rates produces approximately $30.5 million in premium revenue.
[11] Because the transfers distorted the true picture, the Optional capital rebuild increase would need to be on the order of 50%, but because the Optional program is self-sustaining the increase would be one-time.
[12] For example, the administration of the driver licensing program costs Basic policyholders approximately $125 million, and the seniors' discount adds approximately $100 million to the revenue requirement. ICBC policyholders are also funding municipal road and sidewalk upgrades, see http://www.insurancebusinessmag.com/ca/news/breaking-news/icbc-provides-vancouver-with-road-safety-funding-81451.aspx
[13] See http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_36_29_july_2017/pdf

APPENDIX

From 2010 to 2015 the government appropriated almost $1.2 billion of policyholders' Optional capital to reduce the direct debt borrowing requirements. From 2012 to 2017, the government also ordered that almost $1.8 billion of Optional funding be used to keep Basic rates below the actuarially required level to cover the rapid increase in Basic claims costs. By 31 March 2017, the $990 million Optional capital (a ratio of about 138%) was approximately $955 million below the government's 200% regulatory minimum.

Table A shows the beginning capital reserve, the net total comprehensive income (net income plus "other components of equity"), the capital transfers from 2010 to 2016/17, and ICBC's forecast for 2017/18, for the Basic and Optional insurance programs. The information is from ICBC's annual reports. The 31 March 2018 position is derived from ICBC's 2017/18 updated service plan, and the 15 September 2017 Basic rate request to the BC Utilities Commission.[14]

TABLE A -- CHANGE IN CAPITAL RESERVE 2010 TO 2018 ($=million)

	------BASIC-----		----OPTIONAL----		COMBINED
	$	**Ratio**	**$**	**Ratio**	**$**
31 December 2009	1,579	162	2,019	306	3,598
Net Comp. Income	(1,873)		1,495		(378)
Pre-Transfer	(294)		3,514		3,220
To Basic	1,779		(1,779)		---
To Government	---		(1,190)		(1,190)
31 March 2018	1,485	101	545	73	2,030

In the eight years, the Basic program suffered total comprehensive losses of almost $1.9 billion, while the highly profitable Optional program gained almost $1.5 billion.

Had the government not used Optional capital to suppress the Basic insurance rates, the Optional program would have total capital of approximately $2.3 billion (or a ratio of about 295%) by 31 March 2018. No rate increase would have been necessary.

The distinction between net income (or loss) and comprehensive income (or loss) is important. While the annual net income/loss impacts the government's revenue estimates, the change in the comprehensive income directly affects ICBC's capital balances.

[14] For more detail see Occasional Paper No. 41 http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_41_26_september_2017/pdf