OCCASIONAL PAPER No. 48 ICBC

THE FINANCIAL CRISIS AT ICBC: HOW DID IT HAPPEN AND WHAT ARE THE KEY COST DRIVERS?

What have been the main reasons for the current financial crisis at ICBC? ICBC has correctly stated that the rapid growth in both claims and the costs of these claims are the main reasons for the rapid decline in the Corporations' financial condition.

This paper attempts to narrow the discussion by highlighting claims costs, and especially bodily injury claims, as the main driver of the rapid increase in costs.

There has been some speculation that the government intends to restrict pain and suffering payments for minor injury claims to reduce costs and keep rates affordable. But a closer look at the costs of pain and suffering claims for minor soft tissue injuries suggests that capping these costs will not generate the necessary savings required to resolve the crisis.

1.0 The Financial Crisis

The financial crisis at ICBC was not sudden nor unpredictable. It was the result of rising injury and material damage claims and claims costs exceeding the increase in revenue, exacerbated by the previous government's ill-advised policy of restricting the increase in the price of compulsory Basic insurance.

1.1 Operating Costs

In the last five years, ICBC's total revenue increase by 36%, which lagged the growth in expenditures (up 55%) by approximately $760 million.

Table 1 – Marginal Change in Operating Revenue and Expenditure 2011 to 2016/17 (12 months), ($=million)

	----BASIC----		---OPTIONAL---		---COMBINED---	
	$	**%**	**$**	**%**	**$**	**%**
Revenue	**1,043**	**46**	**428**	**24**	**1,471**	**36**
Expenditure						
Current Claims	1,207	62	525	56	1,781	60
Prior Claims	(68)		285		217	
Total Claims	**1,139**	**59**	**808**	**86**	**1,948**	**68**
Other Costs	52	8	228	42	280	24
Total Expend.	**1,191**	**47**	**1,036**	**60**	**2,228**	**55**

Source: ICBC annual report 2011 and BCUC, ICBC 2017 Rate Request, IR 1, RM 1-4, Attachment A.

In the last 5.25 years, Basic insurance rates increased by a cumulative 36% (approximately seven times greater than the BC consumer prices), and total Basic revenue increased by 46%.[1] In the same period, Optional average premium rates declined by some 5%, but the revenue increased because of more sales at a higher value.

Basic expenditures increased by almost 47% (approximately nine times greater than the BC consumer prices), while Optional expenditures increased by 60%, although recent accounting changes have transferred certain Basic costs to the Optional program.

1.2 The Capital Reserves

A focus on the operating revenues and expenditures does not provide the full story on the financial crisis because of the importance of the capital (equity) reserve position in determining the "satisfactory financial condition" of the public insurer.

Changes in the capital reserve position are a product of both the changes in operating net income, and changes in the value of ICBC's assets and pensions. Combined, these are called the comprehensive income or loss.

When the compulsory Basic coverage was separated from the Optional insurance, the government adopted the federal Office of the Superintendent of Financial Institutions (OSFI) capital reserve rules to govern the size of the required reserve.[2] By regulation, the Basic reserve must be no less than the OSFI risk weighed ratio marginal capital test (MCT) of 100%, while the Optional (which competes with private insurers) was set at 200%. Table 2 shows the change in the capital reserve from 2011 to 31 March 2017.

Table 2 – Change in Capital Reserve (Equity) 2011 to 2016/17 ($=million)

	----BASIC----		----OPTIONAL---		---COMBINED---	
	$	**MCT**	**$**	**MCT**	**$**	**MCT**
31 Dec. 2011	1,130	115	1,797	317	2,927	189
31 March 2017	1,456	103	990	132	2,446	112
Difference	326	(12)	(807)	(184)	(481)	(77)
Min. Surp/Defic.	43		(510)		(467)	

Source: Derived from ICBC annual report 2011 and BCUC, ICBC 2017 Rate Request, IR 1, RM 1-4, Attachment A.

[1] The additional 10% was due to growth in policies sold, and the change in the average premium.
[2] More detail can be found in http://www.bcuc.com/Documents/Arguments/2015/DOC_43293_03-12-2015_McCandless_Final-Argument.pdf p. 6.

Over the 5.25 years the combined capital reserve dropped by $481 million, leaving the combined reserves $467 short of the government's combined regulatory minimum levels.

The previous government's policy of suppressing the rate of Basic premiums resulted in a structural deficit, requiring a combined $1,31 billion in transfers from the Optional program to keep the capital ratio above the 100% minimum.

Table 3 shows the "normalized" change excluding the transfers.

Table 3 – Change in Capital Reserve (Equity) 2011 to 2016/17 ($=million)

	----BASIC----		----OPTIONAL---		---COMBINED---	
	$	**MCT**	**$**	**MCT**	**$**	**MCT**
31 March 2017	1,456	103	990	132	2,446	112
Excl. Transfers	(1,309)		1,309		0	
Normalized	147	10	2,299	306	2,446	112
Min. Surp/Defic.	(1,267)		800		(467)	

Note: Transfers were 2012=$373 million, 2013=$113 million, 2015 and 2016/16=$823 million. Excludes additional $514 million of Optional "excess" capital transferred to BC government.

The $1.3 billion in transfers kept the Basic year-end capital above the regulatory minimum level, but has distorted the true picture as to the locus of the financial crisis.

Minister responsible David Eby said in the legislature that future capital transfers from the Optional program are no longer an option. "We will make those changes that are necessary to get ICBC back on firm financial footing, but the cupboard is bare as far as further transfers. We cannot rely on this to deal with the crisis that we're facing in terms of a go-forward basis."[3]

2.0 A CLOSER LOOK AT BASIC CLAIMS COSTS

In the last 5.25 years, both the number of Basic claims and the average cost per claim have increased.

	Bodily Injury	Property Damage
Increase in Claims	37%	4.5%
Increase in Average Cost	11.6%	30%

[3] BC Hansard, 7 November 2017, p. 1894.

Note; ICBC does not release Optional data claiming the release of historical information may harm its competitiveness. This information was from BCUC, ICBC 2017 Rate Request, IR 1, RM 4.10.

The Bodily injury claims increased by almost 37%, yet the average cost per claim only increased by about 12%. This indicates that many of the claims were for lower amounts (such as minor soft tissue injury) which suppressed the average cost per claim.

Property damage claims (not-at-fault) rose by only 4.5%, yet the average cost per claim rose by 30%. Clearly, the average cost to repair damaged vehicles has become much more expensive since 2011.

2.1 Pain and Suffering Claims Costs

Between 31 December 2011 and 31 March 2017, the cost of settled (closed) Bodily Injury litigated claims has increased by approximately $575 million, or 38.5%.

Table 4 – Change in Cost of Bodily Injury Claims Settled 2011 to 2016/17 ($=million)

	2016/17	5.25 Yr. Δ	Percent
General Damage	1,040	348	50.4
Part 7 Benefits	667	155	30.2
Sub-Total	1,707	503	41.8
Litigation Costs			
ICBC	180	38	27.0
Plaintiff	174	31	21.9
Sub-Total	354	70	24.5
TOTAL	2,061	573	38.5
Part 7 Direct Pay	278		

Source: BCUC, ICBC 2017 Rate Request, IR 1, RM 4.2.

By component, the largest increase in injury claim settlements has been for the pain and suffering (general damage) claims, with an increase of $348 million (50.4%). This was approximately 10 times greater than the increase in BC consumer prices over the period.

The no-fault accident benefit (Part 7 benefits) payments are in two parts.[4] The amounts included within the regulatory caps are paid directly, but not at fault parties must file a claim for any amounts higher than the amount offered by ICBC. Given that the wage loss cap has not increased since 1991 (maximum of $300 per week), higher payments in the litigated component are to be expected.

[4] These include medical and rehabilitation costs, wage loss, home care and death benefits, and are generally paid regardless of liability.

2.2 Minor Soft Tissue Injury Claims

According to recent media reports, the government is considering a change to the tort-based claims model by legislating a cap on the pain and suffering claims for “minor” soft tissue injuries (STI or whiplash related claims). The purpose of limiting these claims is to reduce the value of future claims.[5]

ICBC does not produce a regular report on minor STI claims, but an ICBC study prepared with 2012 and 2015 data on settled (paid) exposures is instructive.[6] Table 5 shows the increase in the number of bodily injury exposures settled in 2015 compared to those settled in 2012.

Table 5 – Growth in Settled BI Exposures 2012 to 2015

	Number	Percent	Paid	Percent	Average	Percent
Minor STI	5,512	33.0	91.1	47.0	1,206	10.3
All Other	2,960	13.3	307.0	27.4	6,275	12.5
Total Settled	8,471	21.9	398.1	30.3	2,347	6.9

Source: BCUC, ICBC 2016 Rate Request, IR 1, RM 3.4 to 4.1.

In the three-year period, the settled minor STI exposures rose by 33%, and the value of the settlements rose 47%. However, the increase in the minor STI total value paid was only $91.1 million compared to $307 million in the value of all other bodily injury claims paid.

Table 6 shows the number and value of settled bodily injury exposures for 2015. The minor STI exposures comprised approximately 47% of all the exposures settled, but less than 17% of the value of the claims paid.

Table 6– Bodily Injury Exposures Settled in 2015

	Settled	Cost ($=mil)	Average Cost
Minor STI Exposures	22,014	285.1	$12,952
All Other BI Exposures	25,192	1,426.5	$56,625
Total BI Exposures	47,206	1,711.6	$36,258

Source: BCUC, ICBC 2016 Rate Request, IR 1, RM 3.4 to 4.1.

What savings are likely from a cap on minor STI pain and suffering costs? Given the lack of detailed data, this is a difficult question to answer. Based on the one-time study, the effect can be crudely estimated.

[5] http://vancouversun.com/news/politics/government-considers-cap-on-minor-injury-claims-to-fix-icbc-finances

[6] A claim can have more than one injury injured person involved, hence the term exposure.

If a $5,000 cap were imposed on the pain and suffering component,[7] an assumption as to what portion of the $13,000 average cost in 2015 was for pain and suffering is required.

Assuming 80%, or $10,400, then a $5,000 cap would save $5,400/claim. Multiplied by 22,000 claims and the total paid savings would have been about $120 million. At 60%, the savings fall to about $62 million.[8]

Few of the minor STI claimants are represented by a lawyer. Therefore, a $5,000 pain and suffering cap on minor STI claims will produce few savings in the current amount paid to lawyers (both plaintiff and defense), medical reports and other disbursements.

Casting A Wider Net

In its recent filings with the BC Utilities Commission, ICBC stated that the financial losses show no signs of easing during the next few years, and warns that "fundamental changes" are required to the current insurance model.[9] Restricting pain and suffering claims is only a part of the broader re-evaluation of the current auto insurance model, and the government should cast a wider net (including ending the use of ICBC to fund government programs or policies[10]) in its efforts to make auto insurance premiums more affordable for vehicle owners.

 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.

[7] This is in line with the cap in Alberta.
[8] Average settlement cost $13,000, of which 60% is for pain and suffering the total is $7,800. If the maximum is $5,000 then the potential savings is $2,800 multiplied by 22,000, or $61.6 million.
[9] See BCUC, ICBC 2017 Rate Request, IR 1, BCOAPO 5.3 and 5.5.
[10] See http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_47_4_december_2017/pdf