

ICBC'S LATEST THREE-YEAR FINANCIAL FORECAST RAISES MANY QUESTIONS

ICBC has identified the major sources of increases in bodily injury claims costs as being an increase in general damages and future wage loss payments; an increase in claim complexity; and the impact of increased legal costs and increased complexity of litigated claims. Bodily injury claims costs are impacted by the processes for the handling of claims, driving behaviour, and the legal environment.

Sound familiar? This rationale was not part of ICBC's 20 February 2018 Service Plan. It was part of ICBC's Basic rate request justification of almost 12 years ago.¹ Apparently little has changed, except the values are much higher.

On 20 February 2018, ICBC's 2017/18 to 2020/21 financial forecast was released as part of the NDP government's three-year fiscal plan.² ICBC forecasts net operating losses of approximately \$1.3 billion for 2017/18 and \$684 million for 2018/19, with the following two years showing a minor loss then a minor gain.

The combined capital reserves drop from \$2.45 billion in 2016/17 to the \$450 to \$560 million range for the last three years; some \$3.0 billion below the government's regulatory minimum levels.

Because ICBC's service plan forecast is directly linked to the government's budget and three-year fiscal plan it should incorporate the most recent financial forecasts; but it also includes certain aspirational elements, particularly in the later years.³

ICBC's 20 February 2018 plan appears (as best one can judge when the assumptions are not stated) to have been developed in some haste and includes many inconsistencies and highly questionable assertions. I conclude that many of the annual changes are not credible.

¹ http://www.bcuc.com/Documents/Proceedings/2007/DOC_14602_B-1-1_ICBC-App-RR-Vol1.pdf p. 2-4.

² <http://www.icbc.com/about-icbc/company-info/Documents/Service-plan-2018-2021.pdf> p. 18. ICBC does not provide separate multi-year forecasts for the compulsory Basic and the Optional coverage (where it enjoys about 90% market share). No information is provided on policies sold, or the number and type of claims. Such information would have greatly assisted in analyzing the forecast.

³ For example, in its pre-election February 2017 forecast for 2017/18 to 2019/20, ICBC forecasted a cumulative operating loss of approximately \$310 million for these years. The current cumulative loss is now estimated at \$2.0 billion – after including almost \$1.1 billion in cost reductions due to Basic coverage changes. One hopes that since 2018 is not an election year that the forecast would be more credible.

Part A attempts to summarize the main findings/concerns, while Part B provides a more detailed view.

PART A – SUMMARY OF OBSERVATIONS AND CONCERNS

GENERAL COMMENTS

The government, through the recently announced changes to the no-fault accident benefits and the cap on pain and suffering claims, has sought to end the string of increasing operating losses by reducing the claims costs. The plan phases-in a net savings of \$1.0 billion over three years allowing ICBC to forecast a \$684 million operating loss for 2018/19, then a small loss and a small profit in the next two years.

The forecast shows no attempt to rebuild the devastated capital reserves during the three-year forecast period. If this was the forecast for a private investor-owned national insurer, the federal regulator would probably take over the administration of the company to protect current and future claimants.

Revenue Forecast

The significant increases in premiums earned (average premium X policies sold in period) suggest rate increases in the order of 5% to 7% for 2018 to 2020.

The three-year increase in investment income (especially for 2010/21) requires explanation considering the \$2.0 billion decline in the asset base reduces the opportunity to earn investment income.

Expenditure Forecast

Current Year Incurred Claims

The forecast anticipates \$1.0 billion in phased-in savings resulting from the planned changes to Basic coverage. The annual changes to the incurred claims costs pre and post coverage change are:

TABLE 1 – PERCENT CHANGE CURRENT INCURRED CLAIMS COSTS

	2016/17	2017/18	2018/19	2019/20	2020/21
Before Changes	11.5	9.8	27.0	(2.7)	12.3
Product Changes		--	(7.8)	(7.4)	(2.2)
ICBC Forecast	Act 11.5	9.8	19.2	(9.3)	10.1

Source: ICBC, Service Plan 2018/19 – 2020/21. 20 February 2018, p. 18.

The 2018/19 pre-change increase of 27% (\$1.37 billion) in the estimate appears unduly conservative, and the 2.7% decline in the pre-change claims costs for 2019/20 – given the growth in sales and other indicators – is inexplicable (and probably an error).

The 12.3% increase in claims costs for 2020/21 seems high given that ICBC will have instituted the limitation on the cost of minor soft tissue claims, which were supposed to

have been the main contributing factor to the rapid increase in claims costs in recent years.

ICBC must explain why almost \$400 million in savings in 2018/19 are anticipated as a result of the announced Basic coverage changes, since most of the claims savings (caps on pain and suffering) will not take effect until after 1 April 2019.

Provision for Prior Years

Each year insurance companies use actuarial forecasting to increase or decrease the estimated cost to eventually settle claims (primarily injury claims).

In recent years ICBC has significantly increased this area of expenditure; from 2015/16 to 2017/18 approximately \$1.14 billion will have been added.⁴ ICBC has justified this large addition by stating that there was a “unexpected spike” in the number of complex (expensive) claims in 2017/18.⁵

TABLE 2 – PROVISION FOR PRIOR YEARS CLAIMS (\$=million)

	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Combined	345.1	202.6	591	(76)	(31)	(55)

Source: FY 2014 from ICBC annual report; 2015/16 and 2016/17 from BCUC, ICBC 2017 Rate Request, IR 1, RM 1-4, Attachment; 2017/18 to 2020/21 from ICBC Three-Year Service Plan, 20 February 2018.

If the funding shortfall was serious enough in the current year to require an allocation of \$591 million, how is it that the ICBC actuaries can reduce the allocation by \$76 million next year?

A swing of this magnitude has a material impact on the net income and requires explanation.

Taxes and Commissions (Premium Deficiency Adjustment)

The annual taxes and commissions paid should increase in line with the annual increase in premium revenue (sales). However, included in this cost category is another actuarial discretion adjustment for the deferred premium acquisition cost, which is forecast to drop dramatically in 2018/19, then rise to about 2017/18 levels the following year. Clearly, the forecasted drop inflates the net income for 2018/19, but is it believable? I doubt it.

⁴ ICBC hints that the cost to settle many complex (expensive) injury claims has recently increased due to higher numbers and higher severity, a form of a lurking expenditure resulting from delayed adjudication.

⁵ ICBC rated a special five-page special feature box in the government’s 20 February 2018 three-year budget plan. See page 62 in http://bcbudget.gov.bc.ca/2018/bfp/2018_Budget_and_Fiscal_Plan.pdf

The Combined Capital Reserve

ICBC's forecast capital reserve for the three-year fiscal plan period is dangerously low, leaving open the very real possibility that an adverse financial event will result in a taxpayer bail-out.

Apparently, the claims costs savings from the proposed changes to the Basic coverage will not generate sufficient operating income to rebuild the Basic and Optional capital reserves by 31 December 2021.

PART B – DETAILED REVIEW

1.0 THE 2017/18 FORECAST

Unlike the September 2017 revised forecast for the current year, where ICBC compared the 2017/18 results to the equivalent 12-month 2016/17 fiscal year, the latest document compares the 12-month fiscal period to the previous 15-month bridge year. Thus, the presentation makes year-over-year comparisons impossible, which may have been the objective.

This has been rectified in Table 3, which shows the comparable 12-month results by major revenue and expenditure category. The last two columns show the change between the February 2018 and the September 2017 forecasts.

TABLE 3 – LATEST FORECAST FY 2017/18 COMPARED TO PRIOR YEAR AND SEPTEMBER 2017 FORECAST (\$=million)

		April to March 12-Month Comparison				Feb.'18 to Sept.'17*	
		2016/17	2017/18	Change	%Δ	Change	%Δ
1	Net Prem Ear.	4,914	5,335	421	8.6	16	0.3
2	Invest. Inc.	624	498	(126)	(20.2)	(1)	
3	REVENUES	5,644	5,948	304	5.4	22	0.4
4	Claim Current	4,612	5,064	452	9.8	345	7.3
5	Prior	202	591	389	92.5	654	n/a
6	Claims Total	4,814	5,655	841	17.5	999	21.5
7	Claim Service	365	395	30	8.2	--	
8	Tax & Comm.	688	801	113	16.4	94	13.2
9	Non-Insur.	127	126	(1)		--	
10	EXPEND.	6,256	7,244	988	15.8	1,093	18.1
11	NET LOSS	(612)	(1,296)	(684)	111.8	(1,071)	476.0

12	Tot. Com. Inc.	(381)	(1,393)	(1,012)	265.6	(977)	140.0
13	EQUITY	2,446	1,053	(1,012)	(57.0)	(977)	(48.1)
14	MCT Ratio	112	34	(78)	(30.4)	(32)	(51.5)
15	Capital Deficit	410	2,240	1,830		1,080	

Source: FY2016/17 from BCUC, ICBC 2017 Rate Request, IR 1, RM 1-4, Attachment; FY2017/18 from ICBC Three-Year Service Plan, 20 February 2018.

Notes; 3) includes revenue from driving demerits and service fees, etc.; (8) includes the commissions and taxes on policy sales as well as the 'deferred premium acquisition cost'; (10) is the total expenditures; (11) is the net operating loss; (12) is the total comprehensive loss; (13) is the year-end equity or capital reserve (14) is the marginal capital test ratio; (14) is the estimated shortfall between the available capital and that required by provincial regulation for the Basic and optional programs.

1.1 DISCUSSION

Revenue

The 8.6% increase in the net premiums earned (average premiums times policies sold) is generally in line with recent annual increases.

Investment income (dividend and net gains from asset sales) is below the levels of recent years, due partly from fewer gains from asset sales?

Expenditures

The estimate of the cost of **current year claims** is just under 10% higher than the prior year, which is an improvement over the 15.2% increase recorded for the 12-month 2016/17 over the 12-month 2015/16. The new estimate for the current year claims costs appears much more realistic than the September 2017 forecast.

The estimate for the provision for **prior years claims** has jumped by almost \$400 million (93%) from the actual amount recorded for the prior year. The decision to boost this allowance was made after the September 2017 forecast which forecast a reduction of \$63 million.

The Taxes and Commissions expenditures are up by 16.4%, which is almost double the increase in the value of premiums earned. This category includes a provision for premium deficiency, and it is assumed that the forecast reflects a significant increase in the actuarial estimate for the premium deficiency.

Net Operating Loss

The latest forecast anticipates a loss of almost \$1.3 billion or double the operating loss for 2016/17. The \$300 million increase in total revenue was more than offset by an almost \$1.0 billion increase in expenditures. The decision to increase the provision for prior year claims and the increase in the premium deficiency explains much (71%) of the increase in the operating loss compared to 2016/17.

Equity/Capital Reserve

The combined 2017/18 year-end capital reserve is forecast at \$1.05 million, a loss of almost \$1.4 billion from the 2016/17 position. The MCT ratio at 34% reflects the loss of capital, and a higher value for each 1% MCT in 2017/18 (\$31 million) compared to the prior year (\$21.8 million).

ICBC has not provided the capital forecast for the Basic and Optional programs, therefore the shortfall to the government's regulatory minimums⁶ is estimated at approximately \$1.8 billion.

2.0 THE 2018/19 FORECAST

Table 4 shows the combined 2018/19 forecast compared to the forecast actuals for the current year. The last two columns show the February 2018 forecast compared to the September 2017 forecast for 2018/19.

**TABLE 4 – LATEST FORECAST FY 2018/19 COMPARED TO PRIOR YEAR
AND SEPTEMBER 2017 FORECAST (\$=million)
April to March 12-Month Comparison Feb.'18 to Sept.'17***

		2017/18	2018/19	Change	Percent		Change	Percent
1	Net Pre Earn	5,335	5,858	523	9.8		48	0.8
2	Invest. Inc.	498	616	118	23.7		78	14.5
3	Total Rev.	5,948	6,593	645	10.8		128	2.0
4	Claim Curr.	5,064	6,038	974	19.2		787	15.0
5	Prior	591	(76)	(667)			(30)	
6	Claims Total	5,655	5,962	307	5.4		757	14.5
7	Claim Serv.	395	440	45	11.4		40	10.0
8	Tax & Com.	801	456	(345)	(43.1)		(328)	(41.9)
9	Non-Insur.	126	131	5	4.0		17	15.0
10	Total Expen.	7,244	7,277	33	0.5		510	7.5
11	NET LOSS	(1,296)	(684)	612	47.2		(382)	(126.5)
12	Tot. Com Inc	(1,393)	(614)	779	55.9		(393)	77.8)
13	EQUITY	1,053	439	(614)	(58.3)		(1,280)	(76.0)
14	MCT	34	11	(23)				

⁶ Basic is 100% and Optional is 200%.

15	Capital Deficit	2,240	3,160	920	41.0			
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Source: FY2016/17 from BCUC, ICBC 2017 Rate Request, IR 1, RM 1-4, Attachment; FY2017/18 from ICBC Three-Year Service Plan, 20 February 2018.

Notes; 3) includes revenue from driving demerits and service fees, etc.; (8) includes the commissions and taxes on policy sales as well as the ‘deferred premium acquisition cost’; (10) is the total expenditures; (11) is the net operating loss; (12) is the total comprehensive loss; (13) is the year-end equity or capital reserve (14) is the marginal capital test ratio; (14) is the estimated shortfall between the available capital and that required by provincial regulation for the Basic and optional programs.

2.1 DISCUSSION

Revenue

The 9.8% increase in the net premiums earned (average premiums times policies sold) is generally in line with recent annual increases and reflects the average 8% combined price increase for 2017. The forecast suggests that a similar combined rate increase is likely for 2018.

Investment income (dividend and net gains from asset sales) is significantly above the forecast for the current year, but no assumption was provided to explain the growth.

Expenditures

The estimate of the cost of **current year claims** is an eye-watering 19.2% (\$974 million) higher than the forecast for the current year. This is after ICBC has subtracted \$392 million due to the “impact of changes to the Basic insurance product” (page 18).⁷

Had the changes not been subtracted the increase would have been \$1,366 million, or about 27%. Such an increase in claims costs in a single year is not credible and requires an explanation.

The estimated \$76 million decline in the provision for **prior years claims** is a \$677 million positive swing (93%) from the amount forecast for the current year. With the cost of current claims forecasted to increase rapidly, one would expect ICBC actuaries to continue to add to the provision for prior years claims (although not to the degree of 2017/18), rather than reduce the allocation. Again, this forecast requires an explanation.

Expenditures in the Taxes and Commissions category show a drop of \$345 million, which is attributable to a lowering in the premium deficiency adjustment (which increased significantly in the prior year). ICBC has not explained this volatility in the estimate for the premium deficiency.

⁷ ICBC did not specify where the net Basic product savings will occur, but current year claims appears to be the only logic category as the announced changes should not affect the provision for prior year claims.

Because of the actuarial changes to the provision for prior years' claims and the premium deficiency, the total expenditures – including an increase of almost \$1.0 billion in current claims costs – are forecast to increase by only 33 million over 2017/18!

Net Operating Loss

The loss of \$612 million is a significant improvement over the 2017/18 forecast, due to the positive changes in the prior year's claims and the premium deficiency.

ICBC is forecasting that the product changes will avoid some \$390 million in costs, but this needs explanation as most of the savings should not occur until 2019/20 (cap on pain and suffering).

Equity/Capital Reserve

The combined year-end capital reserve is forecast at \$ 439 million, a loss of approximately \$600 million. ICBC did not provide a MCT ratio forecast, and I have estimated the combined ratio at 11%.⁸

ICBC did not provide capital forecasts for the Basic and Optional programs, therefore I have estimated the shortfall to the government's regulatory minimums⁹ at approximately \$3.16 billion.

3.0 THE 2019/20 and 2020/21 FORECASTS

The \$1.0 billion in annualized savings resulting from the coverage changes to the Basic program is only a preliminary estimate. A better estimate must await the detailed definition of a minor injury and the actual experience.

Table 5 shows the 2019/20 and 2020/21 forecasts, including the percentage change from the prior year.

TABLE 5—COMBINED FORECAST 2019/20 AND 2020/21

(\$=million)

	2019/20	% Change	2020/21	% Change
Net Prem Earned	6,374	8.8	6,980	9.5
Invest. Income	625	1.5	707	13.1
Total Revenue	7,124	8.1	7,821	9.8
Claims Current	5,479	(9.3)	6,031	10.1
Prior	(31)		(55)	
Claims Total	5,448	(9.6)	5,976	9.7
Tax & Comm.	827	81.3	894	8.1
TOTAL EXPEND.	7,145	(1.8)	7,741	8.3

⁸ Assuming that 1% equates to \$39 million in capital.

⁹ Basic is 100% and Optional is 200%.

NET LOSS	(21)		80	
EQUITY	449		559	
MCT % est.	10		10	
Capital Deficit est.	3,400		3,600	

Source: ICBC 2018/19 – 2020/21 Service Plan, 20 February 2018.

Revenue

During the two years under review the net premium earned revenue increases suggest that annual Basic and Optional rates will increase in the 6-7% range.

The significant increase in investment income for 2020/21 appears to be highly optimistic given the government's 2% inflation rate forecast for the period.¹⁰

Expenditures

Current year incurred claims are forecast to decline by 9.3% in 2019/20 because of the implementation of the Basic coverage changes (such as the caps on pain and suffering for minor injury claims). ICBC has not explained why the claims costs rise by 10% in the next year.

Expenditures in the Taxes and Commissions category show an increase of \$371 million over the 2018/19 figure, which, presumably, is attributable to increasing the premium deficiency adjustment (which decreased significantly in the prior year). ICBC has not explained this volatility in the estimate for the premium deficiency.

Equity/Capital Reserve

ICBC forecasts minimal capital reserves for 2019/20 and 2020/21, in violation of the government's minimum regulatory requirements. The government could be accused of subsidizing the Optional insurance prices by operating with minimal capital reserves.

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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.

¹⁰ http://bcbudget.gov.bc.ca/2018/bfp/2018_Budget_and_Fiscal_Plan.pdf p. 92.

