COMMENTARY **ICBC**

FINANCIAL MELTDOWN AT ICBC MAY FORCE GOVERNMENT BAILOUT

ICBC's Basic filing for 2019/20 asks the B.C. Utilities Commission to approve a 6.3% rate increase (approximately $220 million).[1] The increase is net of almost $1.3 billion in claims costs increases that ICBC expects to avoid through coverage changes (primarily the $5,500 cap on pain and suffering claims for minor injuries) and the reduction in claims litigation.

Unfortunately, ICBC has become less transparent regarding its capital reserves, and the outlook for additional rate increases in the mid-term. Also, the lack of any rate increase announcement for the vital Optional program is concerning, because some 85% of Basic policyholders also purchase their Optional coverage from ICBC.

Financial Meltdown

Attorney General David Eby's colourful characterization of the financial crisis at ICBC as a "dumpster fire" understates the gravity of the crisis. A more apt simile is a nuclear reactor meltdown because the financial damage is not contained in a metal box; instead it can directly affect the province's expenditures as the government may be forced to use taxpayer revenue (or to run an operating debt) to pay future auto insurance claims.

The contamination will occur when the Basic and Optional capital reserves are completely dissipated and the liabilities (primarily claim liabilities) are greater than the assets available. A taxpayer bailout will be required.

ICBC Goes Quiet on Capital Reserve Levels

The 1,400-page submission does not provide a forecast for the Basic operating loss or profit for the next three years, nor of the remaining balance (or loss) in the capital (equity) reserve. All private insurance companies must maintain an adequate capital reserve to protect claimants, and to act as a rate buffer, in the advent of an adverse financial event.

The combined Basic and Optional capital reserve dropped from $3.15 billion in 2015 to $987 million at the end of 2017/18.[2] The latest $890 million loss forecast for the current year would drop the total capital reserve to about $100 million by 31 March 2019.[3]

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[1] https://www.icbc.com/about-icbc/company-info/Documents/bcuc/2019-revenue-requirements-application.pdf

[2] In 2015 the Basic MCT ratio was 83%, while the Optional ratio was 300%.

[3] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_64_icbc_q2_results_24_nov_2018/pdf/occasional_paper_no_64_icbc_q2_results_24_nov_2018.pdf

Assuming the minimum capital test ratio of 100% for the Basic program and 200% for the Optional program, the capital reserve by 31 March 2019 should be about $3.9 billion, a shortfall of $3.8 billion. In February 2018 the government ended the long-standing requirement that the B.C. Utilities Commission set Basic program rates to maintain a minimum 100% MCT ratio for the Basic program. This avoided the need for a massive rate increase to restore the minimum levels.

Table 1 – Capital Reserve and MCT Ratio ($=million)

	2016/17	2017/18	2018/19	2020/21
Basic Capital	1,456	826	70	n/a
MCT Ratio %	103	99	4	n/a
Optional Capital	990	161	e27	n/a
MCT Ratio %	132	e18	e 3	n/a
Combined Capital	2,446	987	e97	n/a

Source: ICBC annual reports, 2019 Basic rate request p. 8A-13.

The rapid decline in the Optional capital reserve reflect the almost $1.8 billion of Optional funding transferred to the Basic program from 2015 to 2017/18, and the losses suffered in recent years. The "e" indicates my estimate.

The Capital Loss Was Foreseen

In 2016, ICBC warned that a low capital reserve level could result in a taxpayer bail-out: "If ICBC's Basic capital level was below the regulatory minimum MCT ratio of 100%, and an extreme adverse scenario occurred, ICBC would be at risk of depleting all of its capital and potentially being unable to pay all of its claims and other obligations. In such an event, ICBC would need to apply to the Treasury Board for additional capital relief and this may have a direct consequence for BC taxpayers."[4]

The consequences of a rapid increase in claims costs, and a government policy of suppressing to required Basic insurance rate increases, are now evident.

How Large a Taxpayer Bailout May Be Required?

This is a difficult question to answer because ICBC has decided to withhold any information on the capital levels for 2019/20. In fact, the 1,400-page rate request does not contain any discussion of the capital targets and the capital management plan.[5]

Finance minister Carole James is clearly worried that the rapid loss of ICBC's capital reserve may require a taxpayer bailout. In the recent second quarter forecast she

[4] BCUC, ICBC 2013 Rate Request, IR1, BCUC 66.5 https://www.bcuc.com/Documents/Proceedings/2013/DOC_37379_B-3_ICBC_IR-Responses_1-99.pdf pdf 1534/1796.

[5] ICBC prefers to re-argue the need to change established performance measures, making trend analysis more difficult.

increased the government's 2018/19 forecast allowance from $350 million to $950 million, partly because of the uncertainty about ICBC's deteriorating finances.[6]

We might expect that the government will set aside some of the 2018/19 surplus to partially re-inflate ICBC's capital reserves.[7] In effect, the government would be restoring the $1.2 billion Optional capital that the Liberal government removed from 2010 to 2015.

The absence of any information on the Optional rate increase, or the Optional capital forecast, suggests that the government will not be increasing the Optional rates to a level sufficient to produce the annual operating surpluses necessary to restore an adequate capital reserve. Low or negative reserve levels will mean that ICBC will enjoy a competitive advantage compared to the private insurers in the Optional market because the private insurers must maintain significant capital reserves.[8]

Summary

ICBC has estimated that it would have required a Basic rate increase of approximately 44% (approximately $1.5 billion) to cover the forecasted costs for 2019/20 (including replacing the $440 million of Optional funding subsidy for the current year). The product reform initiatives, including the cap on pain and suffering claims for minor injuries, is expected to reduce the requirement by 37.4% ($1.29 billion). The remaining increase of 6.3% ($217 million) will be funded by a general increase to Basic rates.

The product reform and the rate increase are designed to end the operating losses in the Basic program. But there is no indication that the current plan will provide enough net income in the medium term to rebuild the Basic capital reserve. This means that the risk of further capital meltdown resulting in a taxpayer bailout to guarantee claim payment for both Basic and Optional programs is now extremely high. I expect that the B.C. Utilities Commission will want to explore the issue of restoring the financial health of the Basic program when it reviews the rate request.

 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 both ICBC's and BC Hydro's rate requests.

[6] https://www2.gov.bc.ca/assets/gov/british-columbians-our-governments/government-finances/quarterly-reports/2018-19-q2-report.pdf

[7] Ms. James already is facing an affordability problem respecting the B.C. Hydro rate increase for 2019 as the auditor general has condemned the deferral of costs and revenues through regulatory accounts.

[8] The federal regulator requires a private property insurers to have an MCT ratio of at least 150%, while most have ratios near 200%.