**PRELIMINARY IMPRESSIONS OF ICBC'S 23 NOVEMBER 2016**

**FIVE-YEAR FORECAST[1]**

Richard McCandless 24 November 2016

## General Points

ICBC presented a form of *status quo* forecast (tables 1 and 2) for the policy years (PY) 2016 to 2020, with 2016 being that filed for the PY2016 rate proposal. Two more favourable forecasts (tables 3 and 4) assume a significant decline in the rate of growth of claims costs and other positive changes. The latter two scenarios fall into the 'hope and prayer' category and do not form part of this review.

Tables 1 and 2 use essentially the same assumptions about key cost drivers. Table 1 shows a cumulative rate increase of **35.5%** for PY2017 to PY2020 (over PY2016 including the 4.9% increase) with **$1.5 billion** of capital added "from other sources" to keep the MCT capital ratio at the regulatory 100% minimum.

Table 2 shows that without the $1.5 billion external capital infusion the Basic capital ratio would decline to 10% by PY2020. Conversely, a cumulative rate increase of **55.4%** would be required to maintain the ratio at the 100% regulatory minimum.

## Issues

### Methodology – Policy Year vs Fiscal Year

The scenario follows the November to October policy year forecasting model. However, Special Direction IC2 (Section 3(1)(b)) requires that rates be set to ensure that the MCT capital ratio remains at or above 100%, especially at **fiscal year-end.**

What this means is that to achieve the minimum 100% by 31 March 2018, the rate change on 1 November 2017 must be significantly higher than the 14.9% shown in Table 2.[2] A simple calculation would suggest that a special 'capital reserve preservation' rate increase of approximately 30% would be needed on 1 November 2017 to achieve the 100% ratio by fiscal year-end. The combined increase of 45% is similar to my estimate in Occasional Paper No. 16,

[1] http://www.bcuc.com/Documents/Proceedings/2016/DOC_48181_B-6_ICBC-Response-to-Ex-A-9.pdf

[2] ICBC hinted at this in response to my question; "Therefore, the rate change would have to be unreasonably high (much higher than 23.8%) in order to earn enough equity to make up the $472 million transfer as well as the favourable impact from the prospective adjustments to achieve the regulatory minimum MCT ratio of 100% by March 31, 2017." See BCUC, ICBC 2016 RRA, IR 1, RM 1.6.

http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_16_november_17_2016/pdf

**Dollars and Key Categories Not Provided**

The changes in the scenario are presented as percentages over the PY2015 approved budget. The actual dollars would have allowed a more detailed analysis. Key categories, such as the number of annualized policies sold, net income, the change in asset values, equity and the change in the unpaid claim liability were not provided, which hampers a more detailed analysis.

**Fiscal Year Including Optional**

The 100% capital ratio must be achieved by fiscal year-end, but fiscal year forecasts were not provided. The BCUC must determine how much credence to place in the scenario which, presumably, depends on Transfers from the Optional program. No forecast for the Optional net income or capital reserve ratio was presented.

In September 2016, the government released its revised Q1 three year forecast for ICBC's combined net income. Without the actual fiscal year projections and the Optional net income it is not possible to compare this forecast to the Q1 forecast.

**Capital and MCT Forecasts**

The future years MCT ratios are suspect. In PY2018 the forecasts show that the infusion of $405 million raises the MCT ratio from 50% to 100%; therefore $810 million is required to meet the requirement. This is $0.81 million/1% MCT. The actual 2015 (adjusted for the $450 million Optional capital infusion) ratio was approximately $12.9 million/1% MCT. ICBC estimated that the 2016/17 fiscal year-end ratio was $13.9 million/1% MCT.[3]

For a capital total of $810 million to equal the 100% ratio in PY2018, ICBC would have to dramatically reduce the unpaid claims liability (the claim backlog). This reduction is not likely, nor has been mentioned by ICBC in its caveats/assumptions.

This discrepancy raises serious questions about the capital forecasts and needs further clarification.

**Assumes That Forecast Hold**

The scenario assumes that the various assumptions, especially those relating to claims costs trends, hold for each year. If the forecasts are optimistic then the equity will decline, reducing the capital reserve and the MCT ratio. This concern is heightened by the recent history of ICBC's forecasts, which have understated the actuals.

[3] Derived from BCUC, ICBC 216 RRA, IR 1, RM 1.1 forecast provided by ICBC.

**Summary**

The “more of the same’ forecast in Table 1 relies on deferring the structural deficit by the infusion of $1.5 billion over four years to keep the Basic capital reserve at the minimum 100%. Where is the government planning to find this money to keep Basic rates below the true level? Reducing the Optional capital reserve to 150% would provide a one-time transfer of approximately $380 million; any further reduction would seriously weaken ICBC’s already precarious financial condition.

The forecast appears optimist, but more data and clarification is required. A fiscal-year based forecast is required as well.

Until the source of the additional $1.5 billion is specified I have no assurance that the forecast is realistic.