**COMMENTARY** **ICBC**

## WILL ICBC AVOID INSOLVENCY BY YEAR-END 2018/19?

On 7 February 2019 ICBC released its summary financial statements for the first nine months of the 2018/19 fiscal year.[1] The statement of financial position showed assets of $18.85 billion compared to liabilities of $18.97 billion, including $13.52 billion as the estimate to settle pending claims.

As of 31 December 2018, ICBC was insolvent, as its obligations to claimants and other liabilities exceeded its assets. But insolvency is not the same as bankruptcy, as explained by the site *Investopedia*;

> Contrary to what most people believe, insolvency is not the same thing as bankruptcy. Insolvency is a type of financial distress, meaning the financial state in which a person or entity is no longer able to pay the bills or other obligations. The Internal Revenue Service (IRS) states that a person is insolvent when the total liabilities exceed the total assets. But a bankruptcy is an actual court order that shows just how an insolvent person or business will pay off his creditors, or how he will sell his assets in order to make the payments.[2]

Obviously, allowing a major public Crown corporation to become insolvent is not only an embarrassment, but has serious implications for the government's three-year fiscal plan as it may require a taxpayer bailout of ICBC. In my commentary of February 10th, I stated that, based on the Q3 report, ICBC was insolvent after the first nine months of the reporting period.

David Eby, the minister responsible for ICBC, stated that ICBC was not insolvent,[3] and this position was echoed by Adam Grossman of ICBC, who stated that "We disagree with Mr. McCandless' position — ICBC is not insolvent .... In addition to the reserves and portfolio referenced above, we are still generating sufficient cash flows from premium revenue and investment income, allowing us to meet our current obligations — this is the key point and we are not, therefore, being backstopped by government."[4]

Mr. Grossman's assertions not withstanding, ICBC has been depleting its equity at a rapid pace, and by the end of the Q3 period it was technically insolvent. Part of the reason for the negative equity position was the depressed value of the financial markets at the end of December, which lowered the fair value of ICBC's equity assets (and its

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1 http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_q3_10_february_2019/pdf/commentary_icbc_q3_10_february_2019.pdf

2 https://www.investopedia.com/terms/i/insolvency.asp

3 https://www.theglobeandmail.com/canada/british-columbia/article-bc-limits-use-of-auto-insurance-experts-in-court-cases-to-spur/

4 https://vancouversun.com/news/politics/b-c-government-to-limit-medical-reports-in-icbc-claims-cases

equity) The markets began to rebound in January restoring some of the lost asset value. If the market strength continues to 31 March 2019 this will be a positive adjustment to the corporation's asset value and equity position.

## Will ICBC by Insolvent by Year-End?

Minister Eby and ICBC management have cited a number of reasons for the continuing growth in the cost of claims. During the last two years ICBC has projected an increase of approximately $1.58 billion to its combined Basic and Optional adjustment for prior years claims reserve, with some $1.0 billion projected for the current year alone (see Appendix). The projected increase in current year claims incurred over the prior year is a comparatively modest $370 million.

ICBC has stated that these large adjustments for prior years claims are required to address a large revealed shortfall in the previous estimates to settle claims. The increase in the provision for prior years claims is the main reason why the current year-end forecast deficit ($1.18 billion) is much higher than the $890 million estimate of November.

In an attempt to ensure that our public auto insurer will avoid insolvency by the end of the fiscal year, the government has sanctioned two important changes that will likely affect the financial assumptions for the current year.

## New Limitations on Injury Settlement Offers

On 12 January 2019, Ian Mulgrew disclosed that ICBC had quietly instituted a new injury claims reserve process designed to reduce the projected cost to settle injury claims.[5] The new strategy places a cap on pain and suffering offers based on the seriousness and recovery time of the injury. Apparently, there are new limitations for the amount of a settlement that can be approved by front-line adjusters, with larger amounts now being escalated to higher authority.

The trial lawyers predicted that these new restrictions would result in more claims being litigated and going to trial. If correct, this will increase the time to settle and increase ICBC's already massive unpaid claim liability, with an increase the shortfall in the equity position.

ICBC did not provide an estimate for the savings for the current year, or the prior years claims cost, as a result of this change in reserving policy. Also, it is unclear whether any estimated savings from this change are already factored into the $1.18 billion year-end operating loss, or whether the change will reduce the forecast claims costs for 2018/19. One could question the reasonableness of ICBC's assumptions if it lowers the forecast

[5] https://vancouversun.com/opinion/columnists/ian-mulgrew-now-a-meat-chart-icbc-trying-to-shortchange-the-injured-lawyers-claim

current and prior years claims costs forecast but does not increase the unpaid claim liability to reflect the accumulation of more claims in the backlog.

**New Limitations on Expert Reports**

Two days after the release of ICBC's disappointing Q3 results  Attorney General Eby announced a significant limitation on the use of expert reports, which Rob Shaw characterized as a last ditch attempt to stave off a taxpayer bailout.[6] The new limits on the number of reports would be effective immediately. This means that the findings (and cost) some reports that are currently in development would not be included in an eventual settlement offer or court award.

The attorney general asserted that too many reports were being ordered, and that the additional reports were not advancing the claimant's interests. "What we're trying to address are the excesses of the system that don't advance any interests. It doesn't advance any interest to have six-plus experts on a claim. It doesn't advance any interests to have a $50,000 expense to resolve a $100,000 claim."[7]

The attorney general stated that the immediate limitation on the number of reports would save ICBC $400 million during the current fiscal year.[8] In response to my question on how the estimate was developed, ICBC stated fewer reports would save about $200 million (a 40% reduction in claimant reports and a 10% reduction in defense reports), while some $200 million would be saved as a result of lower damage payments.[9] The rationale for the second tranche of anticipated savings appears to contradict the minister's assertion that the abundance of reports are not benefiting the claimants' interests.

In attempting to test the reasonableness of fewer reports saving $200 million we must assume that ICBC is applying the savings to the value of all injury claims (both Basic and Optional) that are awaiting settlement. ICBC did not provide this number, but I have estimated the 2018/19 injury unpaid claim liability $9.2 billion. With the limited information available, and using the 2016/17 percentage of disbursements to all paid injury costs for that year, the $200 million estimate is not unreasonable.

This "reasonableness" test has probably been applied by ICBC's actuaries to allow a reduction in the funding for unpaid claims on the year-end comprehensive loss statement, which reduces the operating loss and the loss of equity. Whether when the claims are actually settled in the months (and years) ahead we see an equivalent reduction in actual numbers and payments is unknown.

On the second group of savings, is it reasonable to assume that the limitation on expert reports will reduce the aggregate injury claims costs payments by $200 million? This is entirely unknown and may be a case of wishful thinking. One would expect a judge to

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[6] https://vancouversun.com/news/politics/b-c-government-to-limit-medical-reports-in-icbc-claims-cases
[7] Ibid.
[8] https://vancouversun.com/news/politics/ian-mulgrew-is-insurance-expert-change-long-overdue-or-a-smokescreen
[9] Email from Lindsay Matthews VP, ICBC to Richard McCandless, February 11, 2019.

grant approval for more reports if this will help ensure a "fair" settlement. But the rationale may be enough to convince ICBC's actuaries to again reduce the provision for prior years claims by this amount. This would put less pressure on the net operating loss and the loss of equity.

### New Three-Year Forecast Due on February 19th

The provincial budget and three-year fiscal plan will be released on Tuesday, 19 February 2019. We can expect to see ICBC's new 2019/20 three-year financial forecast, including the forecast for the current year, released when the provincial budget is released.

Will the latest forecast for the current fiscal year show a significant reduction in the just announced operating loss of $1.18 billion for 2018/19? I believe that, because of new restriction discussed, the new forecast operating loss will be in the $800 million to $900 million range (depending on the size of the property damage losses resulting from the February snow storms that hit the Lower Mainland and southern Vancouver Island).

Will the statement of financial position show assets slightly greater than liabilities? Again, this is likely especially if the claims liabilities are reduced as a result of the new injury reserving policy and the limitation on expert reports. Because of these new reserving assumptions, I believe that the 31 March 2019 statements will show ICBC's equity slightly higher than its liabilities, thereby avoiding insolvency.

Perhaps the government will use 2018/19 funds to pay ICBC for those programs that benefit the government, such as driver license administration, enhanced policing, the senior Basic discount and fine collection, to ensure that the assets exceed liabilities.[10]

 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.

10 http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_47_4_december_2017/pdf/occasional_paper_no_47_4_december_2017.pdf

## APPENDIX

## FOUR YEAR FINANCIAL TRENDS

Most insurers estimate claims costs in two categories; the cost of claims incurred in the current year, and any positive or negative adjustment to the estimate for claims from prior years. ICBC has been rapidly escalating the estimate for the cost of prior years claims.

### Table 1 – Current Year Incurred Claims ($=million)

| | 2014 | 2017/18 | 3 Year Δ | E2018/19 | 4 Year Δ |
|---|---|---|---|---|---|
| BASIC | 2,298 | 3,451 | 1,153 | 3,780 | 1,482 |
| OPTIONAL | 1,081 | 1,633 | 552 | 1,675 | 594 |
| TOTAL | 3,379 | 5,084 | 1,705 | 5,455 | 2,076 |

Source: ICBC annual reports, 2018/19 projected from 2018/19 Q3 report inflated by 1.25.

Highlights

- During the period 2015 to 2017/18 total incurred claims costs increased by 50.5% ($1.7 billion); with Basic up 50.2% and Optional up by 51.1%.
- The straight-line projection for 2018/19 shows total claims increasing by 7.3% ($371 million), with Basic up 9.5% and Optional up only 2.6%.

### Table 2 – Adjustment for Prior Years Claims ($=million)

| | 2014 | 2015 | 2016/17 | 2017/18 | E2018/19 | 4 Year Δ |
|---|---|---|---|---|---|---|
| BASIC | 97 | 238 | (78) | 218 | 560 | 938 |
| OPTIONAL | 84 | 6 | 281 | 345 | 460 | 1,092 |
| TOTAL | 181 | 244 | 203 | 563 | 1,020 | 2,030 |

Source: ICBC annual reports, 2018/19 projected from 2018/19 Q3 report inflated by 1.25.

Highlights

- In 2017/18 and 2018/19 (projected) ICBC has increased the reserves for prior years claims by $1.58 billion.
- During 2015 and 2016/17 the increase was a comparatively modest $447 million.