COMMENTARY **ICBC**

ICBC REPORTS MAJOR LOSS IN ITS OPTIONAL PROGRAM

On 31 August 2023, I distributed a review of ICBC's 2022/23 financial results at the corporate level.[1] Subsequently, ICBC posted its full 2022/23 annual report, which provides an opportunity for a review of the financial results at the program level, comparing the results for 2022/23 with the prior year.

ICBC's annual report does not provide any detailed service measures relating to policies sold or claims received or paid. The lack of service measures makes a detailed assessment of the financial results difficult, as the financial information provides only part of the picture. The financial results show what happened, but not why it happened. Because the Basic insurance program is compulsory one would expect ICBC to be more accountable for the operation of this program as a minimum.

1 Comparison to 2022/23

The 2021/22 year was remarkable for two related reasons; the change to a no-fault (Enhanced Care) liability model, and a historic high of $2.2 billion in net income.

As of 1 April 2019, the government legislated a hybrid-tort liability model, where pain and suffering payments for minor injury claims were limited to $5,500, and the resulting savings were used to increase benefits and allow ICBC to record a $1.5 billion in combined profits in 2020/21.

As of 1 May 2021, the legislated no-fault liability model was instituted. Under this model most pain and suffering claims were prohibited, and the resulting savings were used to further enhance benefits, and to rebuild the capital reserves. The 2021/22 fiscal year includes one month of claims under the hybrid-tort model, and 11 months under the no-fault model. The current year claims costs reported for 2022/23 include the no-fault claims, while the adjustment for the previous years include mostly tort-based claims.

2 Comparison of Actual Basic Results to Budget

The 2021/22 annual report provides very limited analysis of the financial results of the compulsory Basic and the Optional programs. A comparison to the budget for these

[1] https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_2022to2023_ar_31_august_2023_1/pdf/commentary_icbc_2022to2023_ar_31_august_2023_1.pdf

programs is not possible as ICBC does not present this information in its service plan. This lack of a program budget limits proper accountability.

3 Basic Compulsory Program

Last fiscal year the Basic program recorded a net operating profit of $389 million, compared to a net operating profit of $1,302 million, after the $396 million rebate was paid to Basic policyholders. For 2022/23, the government required the BCUC to approve a net zero rate adjustment, which included a 11.5% surcharge to build the Basic capital reserve (Rate Stabilization Fund) for the compulsory Basic program. With the change to the no-fault/enhanced care model, ICBC forecast that a 26.5% Basic reduction was possible, but the government allowed it to retain 11.5% to rebuild the depleted capital reserve.

Table 1 shows that the primary reasons for the $913 million negative swing in net income compared to the previous year results. Including the impairment loss on investments, the investment income was approximately $930 million lower than the banner year of 2021/22. Higher interest rates reduced the fair value of ICBC's fixed income investments, while its equity investments suffered due to weak equity markets generally.

Claims costs increased by approximately $400 million, with most of the $311 million increase in current year claims (see Appendix) resulting from vehicle damage cost increases. ICBC states that inflationary cost pressures and more expensive technology were the primary causes of the increase.

The investment losses and claims costs increases were partly offset by the fact that the $396 million excess capital rebate was only for the prior year, thereby increasing the premium income.

TABLE 1 – BASIC INSURANCE FINANCIAL SUMMARY ($=million)

	2021/22	2022/23	Change	Per Cent
REVENUE				
Net Premiums Earned	3,150	3,184	34	0.1
Rebates	(396)	0		
Reported NPE	2,754	3,184	430	n/a
Fees and Other	74	81	7	9.5
Investment Income	986	265	(721)	(73.1)
Impairment Loss	(4)	(216)	(212)	n/a
EXPENDITURE				
Claims -Current	1,849	2,160	311	16.8
Prior Years	(156)	(64)	92	59.0

	Total Claims	1,693	2,096	403	23.8
	Claim Service/Loss Man.	331	315	(16)	10.7
	Administration	138	138	0	0
	Taxes and Commissions	194	214	20	10.3
	Non-Insurance	152	162	10	6.6
	NET INCOME	**1,302**	**389**	**(913)**	**(67.6)**
	EQUITY	**2,274**	**2,821**	**1,046**	**85.2**
	MCT %	**92**	**116**	**24**	**23.4**

Source: ICBC 2022/23 AR, p. 21-22; https://www.icbc.com/about-icbc/company-info/Documents/ar-23.pdf

Current year claims costs increased by $311 million , or 16.8%. Most of this increase was due to higher property damage claims as shown in the Appendix Table A.2.

The equity and the Rate Stabilization Fund (not shown) increased due to the $389 million year-end surplus (retained earnings) and a $750 million decline in the value of the unpaid claims. Some of this decline was the result of tort claims being settled, as well as the 100 point (1%) increase in the discount rate on pending claims costs.

The 116% ratio in the Minimum Capital Test exceeds the former regulatory 100% minimum, which is also the operating target for the MPI Basic program. ICBC did not include the program level MCT ratios in its annual report, but did include them in its less publicized fourth quarter 2022/23 summary.[2]

4 The Optional Program

ICBC has been reluctant to provide much detail about the performance of the Optional program, claiming that to do so much provide a competitive advantage to its private sector competitors. With the introduction of the no-fault/enhanced care liability model this argument will be less persuasive as Intact Financial has abandoned the BC market, leaving only Economical Insurance as the main alternative in the auto insurance sector. ICBC admits that it increased its Optional market share (“penetration rate”) last year but did not provide any information as to the degree of its near monopoly power.

Table 2 shows the 2022/23 results compared to the prior year. Investment income, and the impairment loss, mirror the situation with the Basic program because ICBC operates its investment portfolio as a central operation.

[2] https://www.icbc.com/about-icbc/company-info/Documents/StmtofOperations-Mar23.pdf

The increase in current year claim costs reflects a 37.6% increase in material damage costs. ICBC attributes this to inflation, supply chain disruptions (presumably resulting in higher costs) and more technology such as cameras and sensors on the vehicles.

TABLE 2 –OPTIONAL INSURANCE FINANCIAL SUMMARY ($=million)

	2021/22	2022/23	Change	Per Cent
REVENUE				
Net Premiums Earned	2,030	2,106	76	3.7
Fees and Other	46	54	8	17.4
Investment Income	438	136	(302)	(69.0)
Impairment Loss	(2)	(111)	(109)	n/a
EXPENDITURE				
Claims -Current	1,073	1,542	469	43.7
Prior Years	(274)	483	757	n/a
Total Claims	799	2,025	1,226	53.4
Claim Service/Loss Man.	173	166	(7)	(4.0)
Administration	165	162	(3)	(1.8)
Taxes and Commissions	460	416	(45)	(9.6)
Non-Insurance	--		--	--
NET INCOME	**917**	**(584)**	**(1,499)**	**n/a**
EQUITY	**1,441**	**938**	**(503)**	**(65.1)**
MCT %	**115**	**70**	**(45)**	**(60.9)**

Source: See Table 1.

The new no-fault model has reduced the cost of Optional premiums, which as had significant impact on the income of ICBC's 900 broker agencies, whose commission on Optional sales are calculated on a percentage of the value of these sales. The cost of commissions paid to brokers declined by about $100 million for 2021/22 compared to the prior year, and a further $50 million for 2022/23. This is a 26% decline over the two years.

The MCT of 70% is below of the former regulatory minimum of 200%. The 200% MCT minimum target was established under the tort model, where cost volatility was higher. A lower MCT would be more appropriate and lessen the pressure to raise rates.[3]

[3] https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_capital_build_6_march_2022_2/pdf/commentary_icbc_capital_build_6_march_2022_2.pdf

5 Volatility of Prior Years Adjustment

In 2022/23 ICBC added $419 million as an adjustment to the cost to settle prior years claims, which are primarily tort based injury claims. This increase was in marked difference to the $796 million decrease to the prior years adjustment reported for the previous two years, as shown in Table 3.

ICBC says that this adjustment is necessary because of the emergence of much higher cost tort based injury claim settlements. One must question why these higher estimates were not apparent in 2020/21 or 2021/22 after the wind-up of the tort based liability model. Also, this reversal in the adjustment for prior years leaves the reviewer questioning the effectiveness of ICBC's claims adjuster estimating model.

TABLE 3 – PRIOR YEARS CLAIMS ADJUSTMENT ($=million)

	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23
Basic	218	718	757	(127)	(156)	(64)
Optional	341	443	422	(240)	(273)	483
Combined	1,059	1,161	1,179	(367)	(429)	419

Source: See https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_basic_and_optional_12_september_2022/pdf/commentary_icbc_basic_and_optional_12_september_2022.pdf p. 3 and ICBC 2022/23 AR, p. 21-22; https://www.icbc.com/about-icbc/company-info/Documents/ar-23.pdf

5 The Interplay of Inflation and Higher Interest Rates

Higher interest rates usually decrease the market value of insurers fixed income (bonds) investments, and their lower yields become less attractive to investors. This is reflected as a loss (or impairment loss) on investment income or in the Other Component of Equity.

In its 2023/24 service plan, ICBC estimated that a 1% increase in the interest rate would reduce the value of its fixed income investments by $309 million, but that a 1% increase in the discount rate on claims would reduce the value of its unpaid claims by between $340 to $370 million.[4] In its 2022/23 annual report ICBC states that the increase in the discount rate to 4.7% resulted in a reduction in current and prior years claims costs by approximately $360 million.[5]

Most of the reduction in the value of the claims would have been in the more expensive injury claims. Thus, the year-over-year increase in injury claims costs would have been even higher without the offset provided by the higher discount rate.

[4] https://www.icbc.com/about-icbc/company-info/Documents/service-plan-2023-2026.pdf p. 26.
[5] https://www.icbc.com/about-icbc/company-info/Documents/ar-23.pdf pdf 99/120.

6 The Shift to Higher Material Damage Costs

One of the outcomes of the change to a no-fault model for injury liability coverage is the drop in injury claim costs. This is probably due to the elimination of most legal costs and of the elimination of most pain and suffering claims.

Last year was the first full fiscal period under the no-fault model for current year claims. Compared to 2017/18, where the full tort model was in play, and the 2020/21, where the hybrid-tort (a cap on minor injury pain and suffering claims), the 2022/23 period witnessed a major decline in current year injury claims. This was true for the absolute claim cost estimate and the relative share of total costs.

The material damage costs have grown considerably over these years, far outpacing the volume of vehicles insured, or the rise in inflation. ICBC will need to develop new tools and policies to lower the increase in material damage costs to moderate overall cost increases.

TABLE 4—FOUR YEAR CHANGE IN CURRENT YEAR COSTS ($=million)

	2018/19	2020/21	2022/23	4 yr. Δ	Per Cent
Bodily Injury	3,498	2,359	1,335	(2,163)	(61.8)
Material Damage	1,548	1,349	2,367	819	52.9
Total	5,046	3,708	3,702	(1,344)	(26.6)

Source: Derived from data https://www.icbc.com/about-icbc/company-info/Documents/ar-23.pdf p. 24 and 25. 2018/19 from https://www.icbc.com/about-icbc/company-info/Documents/ar-19.pdf pdf 26/108.

In the four years reviewed the Material Damage costs have increased from approximately 31% of the total costs to about 64% of the total reported. This should moderate the volatility of the change in claims costs in future.

Current Year Outlook

We may have some insight as to the current year outlook when the government releases its Q1 outlook, and ICBC releases its Q1 results in a couple of weeks.

 https://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 is an intervener in the BC Utilities Commission's reviews of ICBC's and BC Hydro's rate requests.

APPENDIX

Current Year Claims

The cost of current year claims (and the adjustment for prior years Claims costs) are estimates developed by ICBC. They are not actuals, only approximations of the eventual cost to complete a claim or exposure. ICBC explains its method to estimate these costs as follows:

> The cost of claims incurred accounts for about two-thirds of ICBC's total costs. Claims-incurred costs are comprised of the expected costs to settle claims for all crashes that have occurred during the fiscal period, regardless of when the crash was reported to ICBC, and the change in estimates for losses that occurred in prior periods. Claims-incurred costs include payments made to settle claims, adjusters' case reserves and actuarial estimates of the additional costs that will be paid on current claims and future claims.
>
> Estimating how much claims will cost in the future involves predicting the future behaviour of incurred claims, taking into consideration the following: changes to the insurance product, closure rates, payment patterns and inflation, consistency of ICBC's claims-handling procedures, the legal representation status of claims and historical delays in claims reporting.[6]

Summary of Expenditures by Program and Claim Type

Unfortunately, ICBC does not disaggregate the program expenditures shown on page 21 (pdf 21/120) of the 2022/23 annual report. It is possible to separate the current year claims costs for the compulsory Basic program from the Optional program between injury and property damage using the data provided on pages 24 and 25.

The current year injury and material damage claims totals shown on page 24 are increased for the change in handling costs (a new item which ICBC added for 2021/22) to match the $3,702 million in total current year claims costs shown on the page 79/81, or pdf 118/120.

The split between Basic and Optional was derived by subtracting the material damage from page 23 between the Basic property damage (e.g., the $863 million for 2022/23)

[6] https://www.icbc.com/about-icbc/company-info/Documents/ar-23.pdf p. 23.

from the total $2,361 million. Once the material/property damage by program was established the injury claims costs for the Basic and Optional programs were derived by subtracting the property damage costs from the program totals for current year claims shown on page pdf 118/120.

TABLE A1 – COMBINED CURRENT YEAR CLAIMS COSTS ($=000's)

	2020/21	2021/22	2022/23	22/23 Δ	Per Cent
Bodily Injury	2,359	1,209	1,335	126	10.4
Material Damage	1,349	1,713	2,367	654	38.2
Total	3,708	2,922	3,702	780	26.7

Source: Derived from data https://www.icbc.com/about-icbc/company-info/Documents/ar-23.pdf p. 24 and 25.

Table A1 shows that current year Bodily Injury claims costs increased $126 million, or 10.4%.

Property, or material damage, costs increased by $654 million, or 38.2%, from the prior year. This marks an increase in the growth of these claims over the 28% increase reported in 2021/22.

TABLE A2 – BASIC CURRENT YEAR CLAIMS COSTS ($=000's)

	2020/21	2021/22	2022/23	22/23Δ	Per Cent
Bodily Injury	1,717	1,223	1,297	74	6.1
Property Damage	455	626	863	237	37.9
Total	2,172	1,849	2,160	311	16.8

Source: Derived from data https://www.icbc.com/about-icbc/company-info/Documents/ar-23.pdf p. 24 and 25.

The Basic program shows a modest 6% increase in current year injury claim costs. However, property damage claims increased by $237 million, or about 38%; the same percentage increase as reported for 2021/22 over 2020/21.

TABLE A3 – OPTIONAL CURRENT YEAR CLAIMS COSTS ($=000's)

	2020/21	2021/22	2022/23	22/23Δ	Per Cent
Bodily Injury	642	(14)	38	52	n/a
Material Damage	894	1,087	1,504	417	38.4
Total	1,536	1,073	1,542	469	43.7

Source: Derived from data https://www.icbc.com/about-icbc/company-info/Documents/ar-23.pdf p. 24 and 25.

The Optional program showed a small increase in injury claims under the no-fault system, and these were probably out-of-province tort claims. Material Damage claims increased by $417 million, or 38%, which was the same percentage increase as reported for the Basic program.