COMMENTARY **ICBC**

ICBC'S SECOND QUARTER 2019/20 FINANCIAL RESULTS

On Tuesday, 26 November 2019, Finance Minister Carole James released the government's financial results for the first six months of the 2019/20 fiscal year. While there was some deterioration in the forecasted year-end position, she was confident that the government would end the year with a slight surplus.

One of the main caveats to the forecast was the final position of ICBC. As of 30 September, the public auto insurer reported a combined net operating loss of $87 million, but these results excluded any negative adjustment resulting from the recent supreme court decision which nullified a $440 million saving in claims costs in 2018/19 resulting from the cabinet-ordered limitation on expert reports.[1]

Of interest is the fact that the ICBC second quarter report did not provide a year-end forecast, while the ministry of finance Q2 report did show a net operating loss of $91 million for ICBC.[2] This compares to a budgeted loss of $50 million for the year.

This paper provides a closer look at the ICBC numbers.

The Problem of Comparability

ICBC is now providing its actual quarterly results (Q1 and Q2) at the level of the Basic and the Optional programs, which is a welcome development as it provides more detail on the revenue and expenditures. Unfortunately, the 2019/20 budget provided in the February three-year service plan was at the combined level. Therefore, it is not possible to compare the second quarter results at the program level with the budget. Nor did ICBC provide any assumptions about levels of service (such as the number of policies sold, or the number and average cost of claims filed) to aid in understanding the six-month results.

I have attempted some high-level projections of the results to develop some *pro forma* assumptions.

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[1] https://www.icbc.com/about-icbc/newsroom/Documents/Q2-stmt-of-ops.pdf
[2] https://www2.gov.bc.ca/assets/gov/british-columbians-our-governments/government-finances/quarterly-reports/2019-20-q2-report.pdf p. 13.

Revenues – Premiums, Fees and Investment Income

- **Generally, projecting the Q2 revenue to year-end suggests that the revenue budget will be achieved.**

Combined Net Premiums Earned (NPE) for Q2 increased by some 9.2% compared to the prior year. Basic NPE increased by only 5.7% despite an average rate increase of 6.3% and an estimated 1% increase in the number of vehicles insured.[3] The Optional increase was 14.1% over the prior years' Q2, reflecting a significant rate increase effective on 1 April 2019.

If one assumes that the Q2 actuals represent 50% of the year-end NPE then a projection of combined NPE of $6.36 billion for the full year is reasonable. This compares to the February budget of $6.4 billion.

Service fees for Q2 increased by 18.0% compared to the prior year. A simple projection for the year suggests that the budget of $135 million may be slightly exceeded.

Investment income is more difficult to forecast. The combined budget was $587 million, and based on the Q2 actuals there is no evidence to suggest that the year-end actuals will show a major variance.

Claims Costs – Current and Prior Years

- **Projecting the Q2 current year claims costs suggests a $500 million reduction by year-end compared to the budget; partly offset by a $330 million increase in the provision for prior years claims.**

Claims costs are the key variable in assessing ICBC's financial results. The budget assumed combined current year claims of $5.5 billion, while a simple projection of the Q2 suggests current year costs of $5.0 billion. Basic claims costs in Q2 were well below the total for the prior year, which reflects the capping of the pain and suffering for minor injury claims. Optional Q2 current year claims costs were some 12.4% higher than the prior year.

ICBC did not provide any assumptions about the number of current claims although it mentioned that there was a lower rate of crashes (frequency) during the first six months compared to the prior year. This appears to be inline with the moderation in claims recorded for last year.[4]

ICBC is also booking more funds for adjustments to the estimated costs of prior year claims, with the Q2 at $319 million compared to the full year budget of only $29 million.

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[3] ICBC did not provide any volume assumptions in its Q2 report. The forecast of the number of policy sales (down by .9% from the budget assumption) was included in the ministry of finance's report; see Ibid. p. 26.

[4] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_69_icbc_year_end_24_july_2019/pdf/occasional_paper_no_69_icbc_year_end_24_july_2019.pdf p. 2.

It claims this is the result of the increasing number and cost of large and complex claims. Yet the vast majority of the increase ($259 million of the $319 million) is shown in the Basic program, not the Optional where one would expect large claims to be recorded.

Projecting the year-end amount for the prior year adjustment is difficult given ICBC's practice of significantly increasing this cost category in recent years as the unpaid claim liability grows. ICBC appears to be admitting that its initial injury claims estimates are too low, suggesting that its claims estimation practices are poor.[5]

Taxes, Commissions and Deferred Premium Acquisition Costs (DPAC)

- **The Q2 results suggest the year-end will approximate the budget.**

ICBC has been using the DPAC to dramatically adjust its net payments for premium taxes and commissions for the last thee years. This has a direct impact on the net income. The February budget combined the three cost categories, while the quarterly reports separate the DPAC from the taxes and commissions making comparability difficult. Projecting the Q2 suggests that the year-end costs will approximate the budget.

Net Income

- **Given the lack of assumptions and analysis provided by ICBC the Q2 results suggest that the year-end forecast of a net operating loss of $91 million is not unreasonable.**

Capital (Equity) Reserve and the MCT Ratio

The Q2 results show a minor improvement in the equity compared to 31 March 2019. This appears to be the result of an increase in the market value of ICBC's fixed income (bonds) due to lower yields.[6] The regulatory minimum capital test (MCT) ratio targets were 100% for Basic and 200% for Optional prior to the financial crisis. The combined capital reserve should be approximately $4.5 billion to $5.5 billion to ensure a proper cushion for adverse events.

The $205 million in equity reported in Q2 includes the $440 million booked as savings in 2018/19 because of the cabinet-ordered limit on expert reports.

[5] Ibid. p. 3.
[6] This assumption is based on the analysis of other auto insurers, as ICBC did not provide any analysis of its results.

Savings Resulting from Limiting Expert Reports

In late 2018/19 ICBC booked a $440 million savings as a result of the cabinet ordered limit on expert reports filed to support injury claims. With the rejection of the limits by the supreme court ICBC and the government are recalculating the savings which will be achieved by proceeding with an amendment to the Evidence Act.[7]

When the government amends the Evidence Act it is possible that ICBC will add $200 million to its provision for prior years claims to reduce the expert report savings booked in the previous year. This outcome was hinted at by Attorney General Eby when he discussed the potential reversal of the expert report savings;

> The impact of the decision is potentially the full $400 million amount back on the books this year. However, our amendments of the evidence act could potentially provide some savings, going forward that would need to be deducted from that. So we're doing the work to determine how much we feel comfortable and that's really not up to us it's how much ICBCs actuaries, and the auditing team, feel comfortable with appropriately claiming in this fiscal year.[8]

ICBC has come some way to providing greater accountability in its quarterly reporting, but it still has much to improve on in providing the media and the public with a proper understanding of its finances. ICBC remains far too opaque in its public reporting.

 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 is an intervener in the BC Utilities Commission's current reviews of ICBC's and B.C. Hydro's rate requests.

[7] http://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_400_million_27_october_2019/pdf/commentary_icbc_400_million_27_october_2019.pdf

[8] https://theorca.ca/resident-pod/the-incredible-shrinking-surplus/

APPENDIX

TABLE 1 – CHANGE IN Q2 2019/20 TO PRIOR YEAR ($=million)

	BASIC		OPTIONAL		COMBINED	
	$	%	$	%	$	%
Net Prem. Earned	98	5.7	169	14.1	267	9.2
Policies Sold #	unknown		unknown		unknown	
Current Year Claims	(354)	(19.0)	110	12.4	(244)	(8.9)
Claims #	unknown		unknown		unknown	
Prior Years Adjust.	16	6.6	(15)	(20.0)	1	--
Claim Services etc.	14	10.2	9	13.8	23	11.4
Investment Income	77	63.6	31	60.8	106	61.6
Net Income Increase	431	--	64	--	495	--
Equity	unknown		unknown		205	n/a
MCT Ratio	unknown		unknown		(4%)	n/a