COMMENTARY **ICBC**

TRACING ICBC'S MISSING $400 MILLION IN CAPITAL BUILD FUNDS

Property and casualty insurers maintain a significant capital reserve to protect current and future claimants, and to buffer annual volatility in premiums. ICBC's recent massive operating losses eliminated its once healthy capital reserve. The government's decision to adopt an enhanced care/no fault liability model is expected to significantly reduce claims and related legal costs, thereby allowing ICBC to reduce premiums and rebuild its capita reserves. In fact, the government ordered the BC Utilities Commission (BCUC) to set aside a rate increase of 11.5% to begin to rebuild the capital reserve.

ICBC's compulsory Basic insurance rate application filed with the BCUC covers a 23-month "policy year" from 1 May 2021 to 31 March 2023. It seeks an initial 26.5% rate reduction, offset by an 11.5% surcharge to rebuild the Basic equity and the capital available. In its original submission ICBC estimated that the capital rebuild surcharge would add approximately $794 million to the Basic equity by 31 March 2023. Yet subsequent submissions forecast an increase of only $393 million, or the equivalent of a 5.6% surcharge.

Contrary to the cabinet direction, it appears that ICBC has taken the half of 11.5% surcharge intended to rebuild the capital reserve to provide for revenue and expenditure contingencies for the 2021/22 and 2022/23 fiscal years.

Rebuilding the Basic Capital Reserve

From 2016/17 to 2019/20, ICBC's year-end equity plunged from $3.1 billion to negative $557 million,[1] although the equity returned to a positive figure early in 2020/21 as financial markets improved. The amount is still well below the industry standard.

In its Basic rate request for the new 23-month rating period, ICBC is seeking the approval of the BC Utilities Commission for a 15% reduction in Basic rates. The 15% reduction reflects the lower costs of the enhanced care/no fault model and is the net of a cabinet ordered 11.5% surcharge to rebuild the Basic capital reserve.[2]

[1] See Table 2.6 in https://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_74_icbc_statistical_summary_9_november_2020/pdf/occasional_paper_no_74_icbc_statistical_summary_9_november_2020.pdf

[2] By OIC 633/20, cabinet ordered the BCUC to use the 11.5% of the rate change to rebuild the Basic equity and capital reserve.

ICBC states that the 11.5% surcharge results in a cumulative capital build for the 23 months to 31 March 2023 of approximately 794 million. Of this, $373 million would occur from 1 May 2021 to 31 March 2022, and $421 million during FY2022/23.[3]

However, in responding to specific questions about its forecast ICBC has disclosed that the capital available by 31 March 2023 will increase by only $393 million, not the $794 million noted in the application. Table 1 compares, all else being equal, the increase in the capital available as stated by ICBC using the 11.5% premium surcharge in its 15 December 2020 rate request (the RRA),[4] and the capital available noted in ICBC's 14 April 2021 response to subsequent information requests (IR Responses).[5] The minimum capital test (MCT) ratio, an industry measure that discounts assets based on risk, is also shown.

TABLE 1 – TWO FORECASTS FOR BASIC CAPITAL AVAILABLE ($=million)

	RRA PY2021		IR Responses	
	Capital Avail	MCT Ratio	Capital Avail	MCT Ratio
31 March 2021	87	5	87	5
Plus 11.5%	373			
31 March 2022	460	28	319	19
Plus 11.5%	421			
31 March 2023	881	60	480	33
Increase from 2020/21	794		393	

Note: A one per cent change in the MCT equates to $19.3 million in 2020/21, $16.7 million in 2021/22 and only $14.75 million in 2022/23.

Why the discrepancy of $400 million between the capital available between the initial request and the 14 April 2021 forecast?

ICBC's Basic Insurance Capital Forecast

To increase the Basic insurance equity and capital available the revenue generated by the 11.5% surcharge would, assuming other forecasted revenues balanced forecasted expenditures, result in an increase to the annual net income and the retained earnings of $793 million. When added to the initial capital of $87 million forecast for 31 March 2021, the total for 31 March 2023 should be approximately $880 million. Table 2 shows ICBC's 14 April 2021 forecast of the growth in Basic equity and the capital available.

[3] ICBC RRA PY2021, Chapter 3, Appendix A.1 https://www.bcuc.com/Documents/Proceedings/2020/DOC_60191_B-1-ICBC-2021-Revenue-Requirements-Application.pdf pdf 123/849.

[4] Ibid.

[5] https://www.bcuc.com/Documents/Proceedings/2021/DOC_62142_B-5-ICBC-Responses-to-BCUC-IRs-No1.pdf pdf 20/433.

TABLE 2 –CHANGE IN BASIC CAPITAL ($=million)[6]

	FY2020/21	FY2021/22	FY2022/23
Retained Earnings Start	(199)	115	240
Net Income	314	125	89
Retained Earnings End	115	240	329
OCE Start	(112)	12	125
Change for year	124	113	69
OCE End	12	125	194
Non-Controlling Interest	9	9	9
Equity	**137**	**374**	**533**
Less Intangible	(49)	(55)	(53)
Capital Available	**87**	**319**	**480**
MCT @ 1% (million) Note	19.27	16.68	14.75
MCT	**4.5**	**19.1**	**32.5**

Note: ICBC did not explain why the cost of a 1% change in the MCT has declined by almost 25% from 2020/21 to 2022/23

The two year forecast shows that the Basic retained earnings (net income) is far less than one would expect if the revenue from the 11.5% surcharge was unencumbered. Therefore, one must conclude that ICBC has anticipated other cost or revenue pressures that will detract from its ability to build the capital reserve to the extent required by the cabinet order.

Did Risk Provisions Reduce the Funds Designed for Capital Rebuild?

In several of its responses to questions on the 23-month financial forecast ICBC has noted that it has included "risk provisions," also known as forecast allowances or contingencies. "ICBC includes risk provisions in its outlook net income figures to recognize the ongoing risks to its forecasts such as the emergence of claims costs that are above and beyond the forecast, as experienced the last few years. More recently, risk provisions are not specific to, but continue to account for the risk of unfavourable emergence in large bodily injury claims, the constitutional challenge regarding legislative amendments in respect of Product Reform, Enhanced Care coverage product change risk (forecasts are highly dependent on third party data for estimates), COVID-19, and volatility in the global investment markets."[7]

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[6] IR 1, BCUC 2.3, https://www.bcuc.com/Documents/Proceedings/2021/DOC_62142_B-5-ICBC-Responses-to-BCUC-IRs-No1.pdf Pdf 20/433.

[7] Ibid. p. 21.

It appears that ICBC has built in certain contingencies in its 14 April 2021 forecast, which probably explains most of the variance between expected increase in equity from the capital rebuild surcharge and the actual increase in the equity and the capital available.

The Appendix provides a summary of certain key revenue and expenditure items from the initial application and the subsequent detailed forecast for FY2022/23.[8]

Revenue

In its 15 December 2020 application ICBC has forecast 2022/23 Investment Income $305 million higher than in its 14 April 2021 response. Premium Revenue in the initial filing is $137 higher, and other income is $38 million higher. A higher revenue forecast would inflate the net income in the initial application.

Claims Costs

Claims costs and claims administration costs are approximately $100 million higher in the initial application compared to the 14 April 2021 filing. A higher initial expenditure forecast would decrease the net income.

Administration, Sales Costs and Non-Insurance

In total, the forecast expenditures for these cost centres are similar between the initial application and the 14 April 2021 forecast.

Summary

Apparently, ICBC over-estimated the investment income revenue in its initial rate application for the coming 23-month rating period. In its detailed forecast of 14 April 2021, ICBC has significantly reduced the revenue forecast and, by extension, the retained earnings. This dramatically lowers the forecast for the capital available as of 31 March 2023, contrary to the intention of cabinet's OIC 633/20.

 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 recent reviews of ICBC's and B.C. Hydro's rate requests.

[8] Because ICBC is filing using a 23-month policy year only the final 12 months closely align to the fiscal year forecast provided on 14 April 2021.

APPENDIX

The following tables summarize the forecasts for 2022/23 in ICBC's initial 15 December 2020 application to the BCUC (Appendix A.1),[9] and the detailed forecasts provided on 14 April 2021 in response to Information Request 1, RM 2.2.[10]

Revenue

TABLE A.1—REVENUE COMPARISON ($=million)

	Appendix A.1	RM 2.2	Difference
Premium Revenue	3,235	3,098	137
Misc. Revenue	108	70	38
Investment Income	565	260	305
Total	3,908	3,428	480

The RRA revenue forecast for 2022/23 is $480 million higher than the IR 1 forecast. The RRA budgets for premium income based on written policies while the RM 2.2 uses earned policies, but the earned total is only approximately $20 less than the written total. The largest difference is in the investment income forecast.

Expenditures

TABLE A.2—CLAIMS COSTS COMPARISON ($=million)

	Appendix A.1	RM 2.2	Difference
Claims – Current		2,496	
Claims – Prior Years		(77)	
Claims – Total	2,606	2,429	177
Claims Service, RS/LM	277	353	(76)

[9] ICBC RRA PY2021, Chapter 3, Appendix A.1 https://www.bcuc.com/Documents/Proceedings/2020/DOC_60191_B-1-ICBC-2021-Revenue-Requirements-Application.pdf pdf 123/849.

[10] ICBC RRA PY2021, IR 1, RM 2.2 Attachment A, https://www.bcuc.com/Documents/Proceedings/2021/DOC_62143_B-6-ICBC-Responses-to-Intervener-IRs-No1.pdf Pdf 639/720.

For this RRA ICBC does not separate the current year claims costs from the adjustment for prior years. These adjustments can have a major impact on the net income and equity.

TABLE A.3—OTHER EXPENDITURES ($=million)

	Appendix A.1	RM 2.2	Difference
Admin. And Insurance	143	140	3
Broker Fees and Taxes	254	211	43
Non-Insurance	130	156	(26)
Total	527	507	20

Net Income and Retained Earnings

The ICBC multi-year financial plan assumes that the net income will be the total of the capital maintenance and the capital build, as this will be treated as retained earnings and increase the capital reserve. For the 23 months to 31 March 2023 the RRA forecast that the capital build will total $approximately $794 million (with $373 million for the first 11 months and $420.7 million for the final 12 months).

In comparison, the net income summary shown in IR 1 RM 2.2 for the 24 months of 2021/22 and 2022/23 is only $214.5 million ($125 million for 2021/22 and $89 million for 2022/23.