BACKGROUND RE: GARY MASON'S ARTICLE IN THE GLOBE AND MAIL

http://www.theglobeandmail.com/news/british-columbia/provinces-file-bungling-has-driven-insurance-corp-of-bc-into-trouble/article34136030/

HOW WAS THE 117% CUMULATIVE INCREASE CALCULATED?

During the review of ICBC's Basic rate request (4.9% versus a forecast requirement of 15.5%), the BC Utilities Commission requested a 2016 to 2020 policy year (November to October) financial forecast. ICBC initially filed the forecast confidentially, claiming that making the numbers public could "prejudice ICBC and its Basic policyholders…."[1] But when ordered by the BCUC it filed the forecast on November 23, 2016.

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

The media focused on the "indicated rate change" from Table 1, which showed a cumulative increase of 42% from 2016 to 2020.

Forgotten was the $1.5 billion in "capital from other sources" required from 2017 to 2020 to keep the Basic capital reserve at the regulatory minimum ratio (risk-weighted assets to risk-weighted liabilities) of 100%.

When translated into an equivalent increase to the Basic rates the combined cumulative increase from 2017 to 2020 is approximately 117%. This is explained in an earlier note I had distributed.

TABLE 1 FUNDING AND EQUIVALENT RATE INCREASE ($=million)

	-------Rate Increase---		***----Capital Addition---***		***--------Total---------***	
	AMOUNT	***PERCENT***	***AMOUNT***	***PERCENT***	***AMOUNT***	***PERCENT***
2017	*179*	*6.4*	*330*	*11.8*	*509*	*18.2*
2018	*221*	*7.9*	*405*	*14.5*	*626*	*22.4*
2019	*263*	*9.4*	*405*	*14.5*	*668*	*23.9*
2020	*221*	*7.9*	*365*	*13.0*	*586*	*20.9*
TOTAL	*884*		*1,505*		*2,389*	
CUM.%		*35.5*		*65.7*		*116.8*

Source: BCUC, ICBC 2016 RRA, Exhibit 6, Table 1.

Notes: The forecast was based on the assumptions detailed in Exhibit 6, which makes no allowance for the ageing customer base, producing less premium revenue per policy due to the 25% senior discount.

ICBC cautioned that the forecast was hypothetical, and conformed with the government's rate suppression policy. This policy limits the growth in the annual basic rate to no more than 1.5% more than the percentage increase of the previous year. The policy, first instituted in 2013, has resulted in a structural deficit in the Basic rates. Because of the rapid growth in Basic expenditure, the limitation on

[1] See http://www.bcuc.com/Documents/Proceedings/2016/DOC_47835_B-2-1-ICBC-IR-No-1-confidential-comments.pdf

the increase in rate revenue results in annual deficits, which decreases the capital reserve. New capital funding is required each year to keep the capital reserve above the 100% regulatory minimum ratio.

Stated another way, without the rate suppression limitation, a 20% increase in Basic rates in 2017 would avoid some $1.7 billion in additional capital infusions from 2018 to 2020, as the structural deficit would be eliminated, and built into the rate base for future years.

THE STRUCTURAL DEFICIT IN THE BASIC PROGRAM

The compulsory Basic insurance was intended to be self-financed on a break-even basis. Shortfalls in any one to two-year period would be covered by the capital reserve until rates or costs could be adjusted. Thus, rates would need to rise to cover cost increases, and the capital reserve would need to be large enough to cover short-term adverse financial events and still be large enough to pay current and anticipated claims.

The ill-conceived government's "rate smoothing" policy has meant that the increase in Basic rates have not kept up with the rapid increase in Basic costs during the last four years. The Basic program now has an annual structural deficit of some $400 to $500 million.

Between 2015 and 2016/17 the government ordered the transfer of $922 million from the profitable Optional program to keep the Basic capital reserve from falling below the minimum level. As noted in ICBC's November 23rd forecast, a further $1.5 billion is need for 2017 to 2020.

THE CURRENT MODEL IS UNSUSTAINABLE

The current funding model, including the current regulatory capital minimums, can only be sustained if the government is prepared to provide an annual taxpayer-funded subsidy to Basic policyholders. The Basic capital reserve is now at the minimum level, and the Optional reserve is near its 200% regulatory minimum level. The government could increase the risk to claimants by lowering the Optional reserve to 150%, but this is a short-term fix. Based on ICBC's forecast, such a change will delay the day of reckoning to 2018.

The following table shows the decline in the Optional capital reserve from year-end 2010 to December 31, 2016 (my estimate).

OPTIONAL CAPITAL CHANGES ($-million)

	INITIAL	TO PROV.	TO BASIC	FINAL	MCT RATIO
2016	1,827	---	(373)	1,454	202
2015	2,113	(138)	(450)	1,525	220
2014	2,122	(139)	---	1,983	298
2013	2,274	(237)	(113)	1,927	304
2012	2,193	---	(373)	1,820	313
2011	1,898	(101)	---	1,797	317
2010	2,261	(576)	---	1,685	312

Source: Derived from ICBC annual reports and 2016 information.

The structural deficit must be eliminated through lowering Basic costs and/or increasing the revenue.

UNPAID CLAIMS LIABILITY

Gary Mason noted a $2 billion Basic claim liability. From 2011 to 2015, the Basic unpaid claim liability increased from $4.8 billion to almost $7.0 billion, an increase of $2.2 billion in four years.[2] The combined Basic and Optional claim liability rose by $2.6 billion (to total $9.1 billion) during the same four years.

The BCUC did not request a fiscal year forecast for the Basic unpaid claim liability, but in response to my request ICBC (October 12th) estimated that the Basic claim liability would rise to $7.73 billion by the end of 2016/17.[3]

The growth in the claim backlog puts pressure on the rates. To preserve the minimum capita test ratio at 100%,[4] every $1 added for claims requires approximately $1.06 in matching risk-free assets (government bonds).

Richard McCandless February 25, 2017. http://www.bcpolicyperspectives.com/

[2] ICBC annual reports.
[3] http://www.bcuc.com/Documents/Proceedings/2016/DOC_47830_B-2_ICBC-IR-No-1.pdf see RM 1.1.
[4] The ratio between risk-weighted assets and liabilities.