COMMENTS ON ICBC'S FEBRUARY 2017 FINANCIAL FORECASTS

On February 21, 2017, the government tabled its 2017/18 budget and forecasts for the next two years. ICBC also released its 2017/18 to 2019/20 service plan, and financial forecasts.

The documents suggest that the deteriorating financial condition of ICBC will continue, raising the risk of a massive rate increase for the Basic program in 2017, or a taxpayer-funded subsidy until corrective action can be taken to restore the financial viability of the Basic program.

The following is a preliminary summary of the net income and equity forecasts for 2016/17 and 2017/18.

NET INCOME

Using the April-March government fiscal year perspective, there has been a serious deterioration in the net income between the February 2016 budget and the Q3 forecast, with the net loss now close to $400 million. This will be the worst net loss in ICBC's history (actual dollars).

The net loss Q3 loss for 2016/17 (15 months) is similar to the $293 million (12 months) recorded for 2015.

NET INCOME Fiscal Year ($=million)

2015 Actual	(293)
2016/17 Feb. 2016	95
2016/17 Q2 Sept.	(79)
2016/17 Q3 Dec.	(396)
Diff. Q3toQ2	(217)

Using ICBC's Service Plan presents a summary that more closely matches the funding requirement view.

Table 2 NET INCOME ($=millions)

	A 2015 12 MON.	2016/17 15 MON.	2017/18 12 MON.
Service Plan February 2016	131	(11)	148
Service Plan February 2017	131	(697)	(144)
Difference		(686)	(292)

The extra three months added to convert from the calendar to the government fiscal year was not matched by sufficient revenue, which partly explains the large loss suffered in 2016/17. Normalizing for the extra three months, the 12-month comparative to 2015 and 2017/18 is approximately $540 million.

CAPITAL RESERVE (EQUITY)

The combination of the government's suppression of the increases in the Basic program rates, combined with the impact of low interest rates, has reduced ICBC's capital reserve from $3.62 billion in 2014, to a forecasted $2.56 billion by year-end 2016/17. Of the $1.06 billion reduction, the government appropriated

$138 million in 2015; the balance was expended covering the Basic insurance operating deficits, and the loss of asset value. ICBC forecast a further loss of $107 million in 2017/18.

The combined risk-weighted asset to liability capital ratio (MCT) was 193 in 2014, and declined to 157 in 2015. The combined Basic and Optional management target, the combination of the targets ICBC and the BC Utilities Commission believe to be necessary for the Optional and Basic programs, is about 190% in 2016/17.

The combined latest capital forecast for 2016/17 is $2.56 billion, or 124% (Appendix). This is approximately $1.33 billion less than the $3.9 billion required to achieve the 190% level. The $2.45 billion capital forecast for 2017/18 is approximately $1.57 billion less than the current management target requirement.

The government has a long-standing regulatory requirement for the Basic program to hold capital at a minimum of 100%, and the Optional to have a minimum of 200%. For 2016/17, this would require a combined capital reserve of approximately $2.84 billion, or some $270 more than ICBC's forecast. The shortfall grows to approximately $480 million in 2017/18.

THE SUPPRESSION OF BASIC RATES CANNOT CONTINUE

The most recent forecast for 2016/17, in keeping with ICBC's minimal transparency policy, does not separate the Basic and optional forecasts. Based on previous detail on the annual reports and submissions to the BC Utilities Commission it is possible to construct fairly accurate financial forecasts for the two programs.

The large and growing structural deficit in the Basic program has resulted in ICBC's total net income being pulled into the negative, which is having a negative effect on the government's revenue and surplus position. The 2017/18 budget seems to indicate a "stay the course" policy.

The continuation of the current rate-suppression policy will result in a large operating deficit for the Basic program for the coming rate year. This is explained in more detail in my Occasional Paper of November 17, 2016.[1]

The government is facing a growing financial crisis in the compulsory Basic insurance program. The Optional program's capital reserve has been depleted to subsidize the Basic rates. The only alternative to a massive rate increase for compulsory insurance is to significantly reduce the incidence and severity of crashes, or lower the capital reserves even lower. The second option is highly risky, and would not be permitted by the federal regulator if ICBC was a private investor-owned insurance corporation.

[1] See http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_16_november_17_2016/pdf

APPENDIX

WHAT SHOULD THE CAPITAL RESERVE BE?

A Management Targets (what has been the approved targets)

	2016/17	2017/18
BCUC says Basic target is 145%	2.010 b	2.045 b
ICBC Board Optional target 260%	1.880 b	1.975 b
Combined	3.890 b	4.020 b
Forecast/Budget February 21, 2017	2.556 b	2.449 b
Shortfall	**1.334 b**	**1.571 b**

- Based on the last declared management targets ICBC has a serious capital deficiency.
- The Combined 2016/17 MCT should be about 190% vs forecast 124%.

B Regulatory Minimum Targets (gov't regulation)

Basic @ 100%	1.386 b	1.410 b
Optional @ 200%	1.450 b	1.520 b
Combined	2.836 b	2.930 b
Forecast/Budget February 21, 2017	2.556 b	2.449 b
Shortfall	**280 b**	**481 b**

- . The Combined 2016/17 MCT should be about 138% vs forecast of 124%.