INSURANCE CORPORATION OF BRITISH COLUMBIA -- OCCASIONAL PAPER NO. 12

THE IMPLICTIONS OF ICBC'S 2016 RATE CHANGES ON ITS CAPITAL RESERVES

On 25 August 2016 the Honourable Todd Stone and ICBC president Mark Boucher announced a proposed 4.9% increase in Basic insurance rates, and a 2.8% increase in Optional insurance rates, effective 1 November 2016. The Basic increase will now be subject to the approval of the BC Utilities Commission, which can only approve an increase in the 4.0% to 7.0% range.[1]

The 4.9% increase for Basic insurance was well below what the rise in claims costs would have required, but cabinet has again intervened in the finances of the public auto insurer to keep the rate impact as low as possible for the 2016/17 fiscal year. It ordered ICBC to transfer Optional net income of $300 million, and capital reserves of $172 million, to the Basic program to lower the indicated rate increase of 15.5% to 4.9% and to keep the year-end capital reserve near the 100% regulatory minimum.[2]

Ian Mulgrew of the Vancouver Sun newspaper (25 August 2106) described minister Stone as "bleakly" agreeing that the serious financial situation would require the government to forego the planned taking of $150 million of "excess" Optional capital (as there would be no excess to take), while ICBC president Blucher, echoing the minister's words during the spring legislative session, called the financial situation "a perfect storm…."

The perfect storm had been raging for some two years. While the latest government actions have temporary righted the ICBC ship a closer inspection reveals that it is sinking ever lower in the water. In my occasional papers 1 through 3 I documented the financial pressures that were impacting the Basic program, the declining capital reserves, and the growth in claims costs.[3]

The Basic insurance program is facing a financial crisis, due mainly to rapidly increasing bodily injury claims costs, rising vehicle damage costs, low interest rates which depress investment income, and government suppression of the required increase in premium rates. A specific analysis of the 2016 Basic submission will follow, but for now it is possible to focus on the impact of the proposed revenue and capital adjustments on the Basic and Optional capital reserve levels.

CAPITAL RESERVES ARE RAPIDLY DECLINING

All insurers require a healthy capital reserve to provide for the actuarially determined cost of settling claims. For many years the government has required ICBC to maintain a minimum weighted asset to

---

[1] Cabinet limited the BCUC's desecration in 2013; the Basic application is found at; http://www.bcuc.com/Documents/Proceedings/2016/DOC_47282_B-1_ICBC-2016-Revenue-Requirements-Application.pdf

[2] OIC 614/16 and OIC 615/16 of 24 August 2016.

[3] See papers at http://www.bcpolicyperspectives.com/blog/categories/occasionals-2

liability ratio of 100% for the compulsory Basic program and 200% for the Optional program. The government mandated that ICBC was to calculate the ratios using the federal OSFI guidelines.[4] Until this year ICBC has maintained that an appropriate working (or management) target capital ratio of 150% was required for Basic, and 260% was required for Optional, although the writer has argued before the BC Utilities Commission that these levels were too conservative and too costly for policyholders. The BC Utilities Commission adopted a Basic management target of 145% a number of years ago.

For the 3.2 million Basic policyholders a 4.9% rate increase may appear, at first glance, to be preferable to the 15.5% increase mentioned by minister Stone and president Boucher, it masks a much more serious problem. To achieve the recent short-term stability, the government has been draining the Basic and Optional capital reserves to what, by April 2017, will be dangerously low levels.

The $300 million transfer of Optional net income (a precedent as previous transfers were capital) may herald a recognition that the pricing of Basic and Optional needs a fundamental re-adjustment. But it has the same effect on the Optional capital reserve as a capital transfer; the government, apparently, did not wish to wait for the funds to become capital by year-end 2016/17.

As noted earlier, the drain on the Basic program's capital reserve has been occurring for at least four years. From 2012 to 2015 the government has ordered ICBC to transfer Optional capital to the Basic program in an attempt to bail out the compulsory program and keep the capital reserve near the 145% management target. Table 1 shows what the Basic reserve would have been without the Optional transfers, what was recorded, and the Optional reserve levels.

CAPITAL RESERVE LEVELS 2012 TO 2016/17 ($=millions)

	Basic Before		Basic After		Optional After	
	$	**MCT%**	**$**	**MCT%**	**$**	**MCT%**
2012	1,055	101	1,427	137	1,820	313
2013	1,230	107	1,716	149	1,926	304
2014	1,260	105	1,633	136	1,983	298
2015	700	56	1,520	120	1,625	236
2016/17	40	3	1,334	102	Est1,000	Est140

Source: ICBC annual reports, ICBC 2016 Basic rate requirements application for Basic reported MCT.

From 2012 to 2015, counting the $450 million transfer ordered by cabinet in October 2015 but effective after the close of the fiscal year, $936 million in Optional policyholders' capital was transferred to the Basic program to suppress the necessary increases and maintain the capital reserve. For 2016/17 (including the $99 million in income to be transferred in 2017/18), the combined income and capital being transferred adds another $472 million, for a total of almost $1.4 billion. From 2012 to 2015 the government also took $514 million from Optional policyholders' capital to offset its borrowing requirements.

The government believes that the 4.9% rate increase for 2016, together with the massive shift from Optional, will result in the Basic program capital meeting the regulatory 100% minimum ratio, but

[4] See Occasional Paper No. 2 for a more detailed discussion of the guidelines.

minister Stone was not asked about the Optional reserve which would appear to be well below the 200% minimum by year-end 2016/17.

The government has foregone its planned taking of $150 million in Optional capital for 2016/17, but under the existing minimum 260% formula the money would not have been defined as "excess" anyway. Instead it forms part of the $170 million in Capital targeted for the Basic bail-out.[5] If the writer's estimate of some $1.0 billion (140% MCT) is accurate we can anticipate that cabinet will reduce the regulatory minimum capital requirement for the Optional program.

OUTLOOK BEYOND 2016/17

When asked about future years, minister Stone said, "Obviously, I can't speak to future fiscal years; those will be decisions … made by the Minister of Finance in the months and years ahead."[6] One can infer from his reply that the minister of finance has been leading the manipulation of ICBC's finances, and perhaps more disturbing, that the government does not seem to have a longer term plan to return the public auto insurer to a more satisfactory financial condition.

Without ICBC becoming more transparent as to the causes and impacts of the recent growth in bodily injury claims costs, and more recently in the rise of vehicle damage claims costs, it is impossible to pin-point where corrective action would be most useful. The government has recognized that more claims adjudication staff are needed to attempt to reduce the growing backlog of unpaid claims (which add to the pressure on rates), but a more fundamental change to the full tort model may be required to restore some stability to ICBC's finances.[7]

Patching and constant bailing is keeping the ship afloat…but for how long?

The writer is a retired senior BC government public servant who's paper on the 40-year financial history of ICBC was published by *BC Studies* in 2013. The same academic journal will be publishing his paper describing the BC government's manipulation of the finances of BC Hydro from 2008 to 2014 in the fall. He has been an intervener in the BC Utilities Commission's 2014 and 2015 reviews of ICBC's rate requests.

[5] The 260% target was established by the ICBC board of directors in 2011. In the spring 2016 session the government assumed the authority to set the Optional capital target, no doubt anticipating another large transfer to the Basic program.

[6] Times-Colonist, 26 August 2016.

[7] The Saskatchewan Auto Fund and the Manitoba Basic insurance programs were not recording significant cost pressures in 2015, nor was Intact Financial, the largest private auto insurer in Canada, excepting the Ft. McMurray fire.