OCCASIONAL PAPER No. 29   ICBC

This paper is in two parts. Part A reviews the change in the Basic and Optional capital reserves from 2012 to 2016/17, while Part B takes a closer look at the growth in the claims backlog.

PART A - WHERE DID ICBC'S CAPITAL RESERVES GO?

As discussed in my occasional papers 27 and 28,[1] ICBC will probably end the 2016/17 fiscal year with both the Basic and the Optional capital reserves below the minimum capital test (MCT) levels required by government regulation.

At the combined, or corporate level, the total capital reserve has dropped by approximately $690 million from 2012 to 2016/17.[2]

The loss of capital has been the result of the government's policy of attempting to provide affordable increases in cost of the compulsory Basic insurance. Since 2012, the increase in Basic insurance rates has been less than the increase in claims costs resulting in a massive $1.1 billion operating loss over the last four years. The persistence of a low interest rate environment has reduced the market value of the fixed income portion of ICBC's assets.

The government has transferred some $1.0 billion in capital and operating funds from the highly profitable Optional insurance program to the Basic program to keep try to keep the Basic year-end capital MCT ratio above the regulatory 100% minimum. From 2012 to 2015, the government appropriated some $500 million of the Optional "excess" capital to reduce its borrowing requirements, but this ended in 2016/17 when no "excess" remained.

Table 1 summarizes the 2012 to 2016/17 change in the year-end capital levels, using ICBC's 2012 annual report and its February 2017 service plan forecast ($=millions).

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[1] http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_27_24_march_2017/pdf
http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_28_30_march_2017/pdf
[2] From ICBC's 2012 annual report and its February 2017 service plan forecast.

TABLE 1 – CHANGE IN CAPITAL 2012 TO 2016/17 ($=million)

	BASIC	OPTIONAL	COMBINED
2012 Year-End	1,427	1,820	3,247
Operating Surplus/(deficit)	(1,103)	1,276	173
Change in Other Equity	(209)	(141)	(350)
Transfer to Government	nil	(514)	(514)
Transfer to Basic program	1,035	(1,035)	nil
2016/17 Year-End	1,150	1,406	2,556

Source: ICBC annual reports 2012 to 2015, my estimate for 2016/17.

In the four years, the shortfall in Basic operations has been mostly offset by transfers from the highly profitable Optional program operating surplus. The combined capital loss of $691 million, combined with the increase in the unpaid claims liability, has dropped the MCT ratio from 200% to 116%.

PART B - IMPACT OF CLAIMS BACKLOGS

Insurance companies try to control the cost of their claims backlogs because the unpaid claims are recorded as liabilities on the balance sheet. The minimum capital test formula requires that the claim liabilities be increased by 6% to reflect a risk factor, therefore 106% in additional risk-free assets are required to maintain the capital ratio. Allowing the claim liability to grow puts pressure on insurance rates, or reduces the claim reserve ratio.

From 2012 to 2016, ICBC has allowed the combined Basic and Optional claims backlog -- the unpaid claim liability -- to grow by $3.0 billion, or 43%.

Intact Financial Corporation, the largest auto insurer in Canada by market share, has been able to keep the value of its claims backlog relatively constant until 2016, when the claims from the wild fire at Ft. McMurray were recorded.

TABLE 2 - UNPAID CLAIMS LIABILITY 2012 TO 2016 ($=billions)

	2012	2013	2014	2015	2016	4 Yr. Δ
ICBC $	7.00	7.51	8.21	9.09	E10.0	3.00
% Δ	7.8	7.3	9.2	10.8	E10.2	42.9
INTACT FIN. $	7.66	8.00	8.02	8.09	8.54	0.9
% Δ	11.2	4.4	0.3	0.9	5.5	11.5

Source: Intact Financial 2012 to 2016 annual reports, ICBC 2012 to 2015 annual reports, and 2016 estimate based on February 2017 service plan.

Notes: Intact Financials' 2012 results effected by an acquisition, and 2016 impacted by Ft. McMurray fire.

Table 3 shows the ratio of the unpaid claims liability to the net premiums earned. It shows that ICBC's ratio, when normalized for price and volume increase as represented by the value of premiums earned, is increasing. This indicates that ICBC is losing ground in terms of controlling or reducing the backlog.

Conversely, Intact Financial has been reducing the proportion of the unpaid claims liability was measured by the net premiums earned.

TABLE 3 - RATIO OF UNPAID CLAIMS LIABILITY TO NET PREMIUMS EARNED

		2012	**2013**	**2014**	**2015**	**2016**
	ICBC Basic	243	246	256	262	262
	Optional	105	112	116	120	126
	Combined	184	191	199	204	209
	INTACT FIN.	117	113	110	101	102

Source: Intact Financial 2012 to 2016 annual reports, ICBC 2012 to 2015 annual reports, and 2016 estimate based on February 2017 service plan.

ICBC'S CLAIMS PROCESSING CAPACITY

From the information available, it appears that ICBC deliberately reduced the number of claims adjudication positions to reduce its operating expenditures.

In 2011, ICBC began a major re-organization of its claims processing organization and business processes. This was linked to a major multi-year renewal of its information processing software and methods, which was collectively called the Transformation Program.

The disruption in the claims adjudication division because of the new organization and process was compounded by the elimination of some 217 FTE positions in the claims division between 2011 and 2016. Table 3 shows the claims division FTE positions from 2011 to 2016.

The reduction in claims processing capacity occurred just as the number and average cost of claims began to rapidly increase. Despite the major growth in claims costs in 2014 and 2015, ICBC continued the reduction in FTE positions in 2015 and 2016.

TABLE 4 - ICBC CLAIMS STAFFING 2011 TO 2016

	2011	2012	2013	2014	2015	2016
FTE	2,663	2.563	2,451	2,538	2,460	2,446
Annual Δ		(100)	(112)	87	(78)	(14)

Source: ICBC RRA 2012, IR 1, BCUC 78.0-2 Attachment A, and RRA 2016, p. 5C-5.

Of interest in understanding ICBC's funding priorities during this five-year period is the change in FTE positions for each major division. Table 5 shows that while the financial services and claims adjudication groups experienced staffing reductions, the number of planning, communications and other corporate services FTEs increased during these five years.

Table 5 – FTE POSITIONS BY FUNCTION 2011 TO 2016

	2011	2016	Change	Percent
Claims Adjudication	2,663	2,446	(217)	(8.1)
Insur. and Driver Licensing	1,009	991	(18)	(1.8)
Finance	408	197	(211)	(51.7)
Information Services (IT)	443	559	116	26.2
Corporate Services	349	393	44	12.6
Executive	25	13	(12)	(48.0)
Transformation Prog.	85	64	(21)	(24.7)
Other	74	63	(11)	(14.9)
Total	5,056	4,726	(330)	(6.5)

Source: BCUC, ICBC 2012 RRA, IR 1, BCUC 78.0-2 Attachment A, and 2016 RRA, p. 5C-5.

ICBC appears to have gambled that the increase in claims costs in 2014 and 2015 was a temporary aberration, but the summer of 2016 it was apparent that the sharp increase in claims costs would not be reversed in the near future.

THREE YEAR OUTLOOK

For the last three years ICBC has assured the Utilities Commission that the new claims adjudication process would eventually help return claim processing efficiency to previous levels. In its 2016 rate submission to the BC Utilities Commission, ICBC has belatedly recognized that the growing claim backlog is having a negative effect on the Basic capital reserve ratio.

ICBC says that the addition of some 80 FTE positions will be added to help keep mitigate the increase in the unpaid claims liability.

> As indicated in the Application, Chapter 5, paragraph 41, the 2016 outlook [budget] includes approximately 80 new FTEs in Claims Injury Services and Claims Legal Services. ICBC is seeing an increasing volume and complexity of claims and is adding additional positions, as required, to help manage claims costs. These additional positions are not included in the 2016 outlook; they are expected for 2017 and beyond ….[3]

ICBC stated, however, that it was still attempting to keep operating costs at the 2014 levels, which indicates that it will be seeking additional revenue to fund these positions, and perhaps additional staff, in 2017/18.

ICBC SLOW TO REACT

The increase of $3.0 billion in the unpaid claims liability in the last four years has, at a minimum, resulted in an increase of approximately $180 million to ICBC's capital requirement to maintain the capital ratio. In 2016, the $180 million is the equivalent of approximately 8 MCT basis points.

In its effort to restrict the growth in "administrative" costs ICBC allowed the claims backlog to increase. The short-term operating savings was illusionary as the result was a further decline in the capital reserve. The impact of the additional claims staff will have a positive effect, but any significant reduction in the unpaid claims liability can only come from a reduction the number and severity of claims.

 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 has been an intervener in the BC Utilities Commission's recent reviews of ICBC's rate requests, and is an intervener in the Commission's current reviews of ICBC and BC Hydro rate requests.

[3] BCUC, ICBC 2016 RRA, IR 1. RM 4.5, see http://www.bcuc.com/Documents/Proceedings/2016/DOC_47830_B-2_ICBC-IR-No-1.pdf