OCCASIONAL PAPER No. 66 ICBC

OBSERVATIONS ON ICBC'S FINANCAL FORECAST AND THE NEW FISCAL PLAN

On 19 February 2019 the government released ICBC's 2018/19 year-end forecast and its three-year service plan forecast.[1] The latest forecast and the three-year plan are based on a number of key assumptions, but most of these assumptions were not included in the financial forecast making verification all but impossible.

ICBC has a poor track record regarding the accuracy of its previous service plan financial forecasts, as actual costs in recent years have been significantly higher than the service plan forecasts. It would appear that this time the corporation is overstating its forecasted claims costs to ensure that its actual results are better -- or no worse -- than the yearly forecasts.

This paper will review the reasonableness of the financial forecasts. It will also discuss some of the comments that have been made about the plan to address the financial crisis at ICBC.

Summary of the Financial Plan

Table 1 summarizes the annual change in the combined Basic and Optional operating income (or loss), and the change in the capital reserve (equity) for the next three years compared to the forecast for the current year and the actuals for 2017/18.

Table 1 – ICBC COMBINED FINANCIAL RESULTS

		A2017/18	F2018/19	E2019/20	E2020/21	E2021/22
	Operating Gain (Loss)	(1,325)	(1,180)	(50)	86	148
	Change in Asset Value	(134)	(80)	93	139	135
	Change in Equity	(1,459)	(1,260)	43	225	283
	Prior Year Equity	2,446	987	(273)	(230)	(5)
	Net Equity	987	(273)	(230)	(5)	278

Source: ICBC 2017/18 annual report and 2019/20 to 2021/22 service plan.

Notes: FY2017/18 are actuals.

The new three-year plan has the combined Basic and Optional operations near break-even in the coming year, with some modest profit recorded in the next two years. The split between the financial projections of the break-even Basic program and the for-profit Optional program was not provided. ICBC is seeking a 6.3% Basic rate increase

[1] https://www.icbc.com/about-icbc/company-info/Documents/service-plan-2019-2022.pdf

for 2019/20 which is forecasted to result in a break-even operating result. Since ICBC is forecasting an operating loss for the combined programs next year we must assume that the Optional program will show a loss of $50 million.

The Funding is Insufficient to Restore the Capital Reserve

ICBC's structural deficit, especially in the Basic program, rapidly depleted its capital reserves, and by 31 March 2019 ICBC will be insolvent.[2]

The small operating loss forecast for 2019/20 is offset by an increase in the value of ICBC's assets which slightly improves the negative equity position. By 2020/21, a small operating gain and improved asset values essentially eliminates the negative capital position.[3] No assumptions were provided on why the value of the assets will increase.

The government had the opportunity to significantly rebuild the Optional capital reserve by returning the $1.2 billion "excess capital" appropriated from 2010 to 2015. The government chose instead to avoid reinstating taxpayer direct debt, and operate ICBC with the taxpayer backstopping the claim liabilities.[4]

If, however, the forecast net income for the next three years is much higher than shown in the latest service plan the retained earnings will increase the reserves more quickly than suggested by the three-year forecast. This would occur if ICBC is over-stating its forecast expenditures.

Is ICBC Overstating Claims Costs for 2019/20?

The government has addressed the financial crisis by modifying the tort-based claims model. By capping the value of pain and suffering awards for minor injury claims at $5,500 for all claims incurred as of 1 April 2019 ICBC estimates that Basic current claims costs will be reduced by $1.2 billion.[5] The savings estimate is net of the additional cost to be incurred by increasing the no-fault Part 7 accident benefits.

The $1.2 billion saving is incorporated in the 2019/20 current year claims cost estimate of $5.499 billion. Therefore, had the Basic coverage changes not occurred we must assume that the claims costs estimate would have been approximately $6.7 billion (the current forecast of $5.5 billion plus the $1.2 billion reduction). But is status quo forecast

[2] The February 19th forecast is for negative equity of $273 million; see also http://www.bcpolicyperspectives.com/media/attachments/view/doc/comment_icbc_14_february_2019/pdf/comment_icbc_14_february_2019.pdf

[3] The 100% MCT minimum capital requirement for the Basic program was suspended for 2018 to 2022. The corporation has not disclosed its Optional MCT target, but it used to be in the 250% to 260% range.

[4] The private insurers who compete for the Optional market are likely to claim that this gives ICBC an unfair advantage and is contrary to the notion that the Optional program should not receive a subsidy.

[5] This was the basis of the Basic rates request filed with the B.C. Utilities Commission on 14 December 2018; see https://www.bcuc.com/Documents/Proceedings/2018/DOC_53062_B-1-ICBC-2019-RRA.pdf

of current year claims costs at this level – some $1.28 billion or 23.7% more than the $5.42 billion forecast for the current year – realistic?

The increase in actual combined current year claims for the 3.25 years period 2014 to 2017/18 was $1.7 billion, or an average of 15.5% per year. The increase in current claims costs for 2017/18 over the prior year was 10.2%, while the forecast for the current year is for a 6.5% increase over 2017/18 .

What then explains the 23.7% status quo forecast for next year? If the increase for the coming year was 8% greater than the 2018/19 forecast the status quo result would be $5.85 billion. Subtracting the net Basic coverage savings of $1.2 billion, the post change estimate of $4.65 billion is approximately $850 million lower than ICBC's estimate for 2019/20.

This would result in a net income of $800 million, rather than a forecasted loss of $50 million, for the coming year and equity increasing to $670 million.

Is ICBC Overstating Claims Costs for 2021/22 and 2022/23?

I also question the increase in the cost of current year claims for the 2021/22 (up 8.8%) and for 2022/23 (up 8.6%), as these increases are much higher than the 6.5% increase for 2018/19.

For years ICBC has used the growth of soft tissue injuries and the growing legal representation as reasons to explain the growth in claims costs. One would reasonably expect that the cap on the minor injury pain and suffering awards, and the new civil resolution process, would result in a much smaller increase in claims costs, rather than the annual increases forecast by ICBC.

No justification was provided by ICBC to support its current year claims costs forecasts for these years. However, these forecasts require a significant increase in premium rates to produce the positive net income.[6]

Are the Assumptions that Underpin the Requested 6.3% Basic Rate Increase Now Out of Date?

In late November 2018 the attorney general announced that ICBC's combined operating loss for 2018/19 would be $890 million. He did not provide a forecast for the capital (equity) reserve. In mid-December ICBC filed its 6.3% Basic rate increase request for 2019/20 with the B.C. Utilities Commission.

On 7 February 2019 the attorney general announced that the combined current year operating loss was now forecast to be $290 million higher. Does this new forecast mean

[6] Investment income is also forecast to increase almost 48% ($260 million) from 2018/19 to 2021/22, and again no justification was provided.

that the 6.3% Basic rate increase requested in December is too low? We are left to wonder whether the 6.3% rate increase was based on the November 2018 forecast or the February 2019 forecast. Attorney General Eby stated that the higher forecasted loss for 2018/19 would not result in a higher rate request for 2019/20; perhaps he had been advised by ICBC management that the conservative three-year plan left significant lee way for course corrections.

The Losses at ICBC Do Not Affect the Government's Expenditure Plans

Some commentators have stated or implied that ICBC's operating and capital losses have restricted the government's spending plans. In a recent editorial the Globe and Mail stated that the government was relying on the net income from B.C. Hydro and ICBC to continue to record small surpluses.[7] The standard accounting for self-supporting Crown corporations (or government business enterprises) supports this misconception, because the net income of B.C. Hydro and ICBC is included with the government's revenue when calculating the annual surplus or deficit.[8]

But on a cash basis -- the money that is actually transferred to the government -- the picture is quite different. While ICBC's $1.3 billion operating loss for 2017/18 and the forecast $1.2 billion loss for 2018/19 reduced the reported consolidated revenue, there was no reduction in taxpayer supported expenditures because the loss depleted ICBC policyholders' equity rather than being funded by the taxpayer (government).

In fact, the reversal of the large losses at ICBC provides cover for the government to significantly increase expenditures in 2019/20. Table 2 shows the standard view summary of the government's revenue and expenditures for the new fiscal plan.

Table 2 – FISCAL PLAN ($=million)

	2018/19	2019/20	2020/21	2021/22
REVENUE	56,636	59,047	60,038	62,458
EXPENDITURE	(56,262)	(58,773)	(59,751)	(61,873)
SURPLUS/DEFICIT	374	274	287	585

Source: B.C. Budget and Fiscal Plan 2019/20 to 2021/22.

Table 3 presents a revised surplus/deficit summary after excluding the net income for B.C. Hydro and ICBC from the government revenue. This "cash" view shows that while the 2019/20 revised revenue will increase by approximately $1.0 billion, the 2019/20 expenditures will increase by approximately $2.5 billion.

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[7] https://www.theglobeandmail.com/opinion/editorials/article-globe-editorial-in-bc-an-ndp-budget-balanced-between-prudence-and/

[8] This accounting issue was reviewed a year ago in http://www.bcpolicyperspectives.com/media/attachments/view/doc/accounting_rule_adds_complexity_17_feb_2018/pdf/accounting_rule_adds_complexity_17_feb_2018.pdf .

Table 3 – FISCAL PLAN EXCLUDING B.C.HYDRO and ICBC NET INCOME ($=million)

		2018/19	2019/20	2020/21	2021/22
	REVENUE	56,636	59,047	60,038	62,458
	Exclude ICBC net income/loss	1,180	50	(86)	(148)
	Exclude BC Hydro net income	(526)	(712)	(712)	(712)
	BC Hydro dividend	59	--	--	--
	REVISED REVENUE	57,349	58,385	59,240	61,598
	EXPENDITURE	(56,262)	(58,773)	(59,751)	(61,873)
	REVISED SURPLUS/DEFICIT	1,087	(388)	(511)	(275)
	REPORTED	374	274	287	585

Source: B.C. Budget and Fiscal Plan 2019/20 to 2021/22.

The Government Avoids Providing Direct Relief for ICBC Policyholders

The government has decided not to provide direct taxpayer support to ICBC to avoid the embarrassment of the public auto insurer becoming insolvent in 2018/19, and not regaining positive equity until perhaps 2020/21. It has again ignored the fact that ICBC's Basic policyholders are providing a subsidy to the taxpayers by funding the cost of issuing driver licenses, funding the cost of the government-ordered seniors' subsidy, enhanced policing and the cost of provincial fine enforcement. The cost of these subsidies is about $200 million annually.[9]

The government did find new funding to enhance the operations of the B.C. Ferries, and to eliminate the tax on non-residential electricity sales. By comparison, ICBC policyholders are left to accept reduced financial coverage for injury claims and higher penalties for at-fault crashes to restore some balance in ICBC 's operating income. However, no plans have been announced to rebuild the capital reserves before the 100% minimum capital ratio is restored of 2022/23.

 February 26, 2019. 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 both ICBC's and BC Hydro's rate requests.

9 http://www.bcpolicyperspectives.com/media/attachments/view/doc/occasional_paper_no_47_4_december_2017/pdf/occasional_paper_no_47_4_december_2017.pdf