OCCASIONAL PAPER No. 71 ICBC

ICBC 2019/20 ANNUAL REPORT: MANY FACTORS CONTRIBUTE TO FURTHER LOSSES AND NEGATIVE EQUITY

On Monday, the government permitted ICBC to release its annual report for 2019/20.[1] This paper reviews certain positive and negative aspects of ICBC's financial results, and suggest areas for closer examination. As usual, practically all the report discussion is focussed on the corporate level with only a single fine print summary which provides separate financial information for the compulsory Basic program and the Optional product.

Any detailed analysis of the 2019/20 results compared to the budget or to prior years is complicated by significant changes to the insurance products and the economy that during these twelve months. These include the limitation on payments for pain and suffering for minor injury claims, a new dispute resolution process for most injury claims, the introduction during the year of a new the formula to calculate premiums, and the financial disruption as a result of the COVID-19 pandemic.

The economic disruption caused by the COVID-19 had some impact on ICBC's sales and claims in March 2020, but the corporation did not provide details. The drop in interest rates and the sharp decline in the value of ICBC's equity investments in March did have a significant impact, but the corporation only highlighted the loss in the value of it equities. The "impairment loss" totalled $317 million, which was a key reason for the operating loss of $375.6 million.

PART A -- COMPARISONS

Comparison of Actuals to the 2019/20 Budget

In its February 2018 service plan ICBC forecast a combined net operating loss of $50 million and year-end negative equity of $230 million as of 31 March 2020.[2] The actual operating loss was $376 million, while the losses in the value of equity investments were a major reason resulted in a year-end negative equity of $547 million.

Excluding the impairment loss, the net loss would have been inline with the budget loss planned in February 2019.

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[1] https://www.icbc.com/about-icbc/company-info/Documents/ar-20.pdf

[2] https://www.icbc.com/about-icbc/company-info/Documents/service-plan-2019-2022.pdf p. 18. Unfortunately, ICBC does not separate the budget between the compulsory Basic and the Optional programs.

The main reasons for the variance between the February 2019 budget and the actuals were:

- Lower net premiums earned under budget by $118 million
- Higher provision for prior years over budget by $1.1 billion
- Unknown cost of Crowder decision in prior years
- Lower cost of current claims under budget by $771 million
- Higher investment income over budget by $471 million
- Investment impairment loss over budget by $ 317 million

Table 1 – ACTUAL TO BUDGET CORPORATE SUMMARY ($=million)

	Budget	**Actual**	**Difference**	**Per Cent**
Net Premiums Earned	6,404	6,286	(118)	(0.5)
Other Revenue	135	148	13	2.8
Total Revenue	6,539	6,434	(105)	(0.4)
Claims – Current	5,499	4,728	771	(0.4)
Prior Years	29	1,180	(1,151)	28.0
Total Claims Cost	5,528	5,908	(380)	4.2
Tax, Comm. & DPAC	748	741	(7)	(0.9)
Other Costs	768	768	--	--
Total Costs	7,044	7,417	(373)	3.1
Investment Income	587	1,058	471	80.2
Impairment Loss	nil	(317)	(317)	n/a
Non-Insurance Costs	132	134	2	1.5
NET INCOME (LOSS)	**(50)**	**(376)**	**(326)**	**n/a**
EQUITY	**(230)**	**(547)**	**(317)**	

Source: ICBC 2019/20 service plan and 2019/20 annual report.

Comparison to 2017/18 Actuals

Table A1 compares the actual 2019/20 results to the actuals for the prior year at the corporate level.

Table 2 – CORPORATE SUMMARY ($=million)

	2018/19	2019/20	Difference	Per Cent
Net Premiums Earned	5,823	6,286	463	7.9
Other Revenue	125	148	23	14.4
Total Revenue	5,948	6,434	486	8.2
Claims – Current	5,308	4,728	(580)	(10.1)
Prior Years	1,221	1,180	(41)	(3.3)
Total Claims Cost	6,529	5,908	(621)	(9.5)
Tax, Comm. & DPAC	307	741	434	142.1
Other Costs	698	768	70	10.0
Total Costs	7,534	7,417	(116)	(1.5)
Investment Income	581	1,058	477	82.1
Impairment Loss	(24)	(317)	(293)	n/a
Non-Insurance Costs	126	133	7	5.6
NET INCOME (LOSS)	**(1,154)**	**(376)**	**778**	**n/a**
Total Comp. Loss	(868)	(665)		
EQUITY	**119**	**(547)**	**(666)**	**n/a**

Source: ICBC 2019/20 annual report.

The operating loss of $376 million was an improvement compared to the $1.15 billion loss recorded last year. The main reasons for the variance were:

- Higher premiums earned — higher by $463 million
- Lower claims costs, especially injury claims — lower by $621 million
- Unknown cost of Crowder decision in prior years
- Much higher Deferred Premium Acquisition
- Higher net investment income after impairment — higher by $184 million

What ICBC Says[3]

ICBC provided some explanation for the variances, but once again it did not release actual service measures. Nor did it elaborate by providing more detailed information, such as the financial impact of the Crowder decision.

Overall

Compared to budget, the current year's net loss was $326 million higher than the budgeted net loss of $50 million. This was largely due to higher than expected prior years' claims adjustments

[3] https://www.icbc.com/about-icbc/company-info/Documents/ar-20.pdf beginning on page 25.

as the result of the reversal of savings from the Crowder decision, lower discount rate, and the increased emergence of large bodily injury claims from prior years.

Premiums earned

Premiums earned in 2019/20 were $6,286 million, which is an increase of $463 million compared to 2018/19. This is due to the growth in the number of insured vehicles [*number not provided*] and the impact of the Basic insurance rate increase of 6.3 per cent effective April 1, 2019. Optional insurance rate increases [*not* provided] also contributed to increased premiums earned. Premiums earned were lower than budget due to a lower average premium per policy [*why?*] and lower policy growth than expected [*what was expected?*]. Lower premium per policy compared to budget was largely due to the impact from customers listing fewer high-risk drivers than expected with the introduction of a driver-based insurance model in September 2019.

Claims Costs

For this fiscal year only, the provision for claims occurring in the current year, or current year claims costs, would be reflective of the April 1, 2019 minor injury cap product and the changes in the estimates for losses that occurred in prior periods would be reflective of the pre-April 1, 2019 full tort product.

Overall, 2019/20 net claims incurred costs of $5,908 million were $621 million lower than the claims costs incurred in 2018/19. This is mainly due to the April 2019 reforms and reduced crash frequency [*no detail provided*], partly offset by the reversal of savings from the Crowder decision [*no amount provided*] and a lower discount rate [*impact?*].

In 2019/20, the change in estimates for losses that occurred in prior periods was $1,180 million and had a significant negative impact on ICBC's fiscal year bottom line. This is a result of an increase in the estimated number of large and complex pre-April 2019 full tort product injury claims [*no detail provided*] that will develop over time, the reversal of savings from the Crowder decision [*no amount provided*] and the lower rate to discount claims costs [*what impact?*].

PART B – COMMENTARY

The Negative Equity Is Serious

Table 3 shows that in the last five years ICBC policyholders have lost $4.1 billion in equity. The $317 million loss of market value of the equity assets as of 31 March 2020 was a timing issue; most or all of the loss should have been recouped as the equity markets in Canada has rebounded.

However, even if the "impairment loss" is transitory, there remains a large gap between the actual equity and the capital buffer (as measured by the minimum capital test formula) needed. Calls for a COVID-19 rebate are premature. The government's February 6th promise of a 20% rebate on premiums resulting from the planned switch to a no-fault model may also be too risky.

Table 3 – DETERIORATION in YEAR-END EQUITY ($=million)

	2014	2015	2016/17	2017/18	2018/19	2019/20
BASIC	1,633	1,071	1,456	831	167	(301)
% change	(4.8)	(34.4)	35.9	(42.9)	(79.9)	n/a
OPTIONAL	1,983	2,075	990	156	(48.0)	(246)
% change	2.9	4.6	(52.3)	(84.1)	--	n/a
COMBINED	3,616	3,146	2,446	987	119	(547)
% change	(0.7)	(13.0)	(22.3)	(59.6)	(88.0)	n/a

Source: ICBC annual reports.

The Reduction in Current Year Claims Costs is Encouraging

The $721 million reduction in the estimated cost of current year claims is encouraging, as it shows that the cap on pain and suffering claims for minor injury claims appears to be achieving the planned results. Unfortunately, ICBC does not include actual claims numbers in its annual reports so it is difficult to separate savings from fewer crashes/claims from a lessening in the average cost per claim. ICBC does not separate injury claim and property damage claims at the program level.

Table 4 – MARGINAL CHANGE IN CURRENT CLAIMS COSTS ($=million)

	2014	2015	2016/17	2017/18	2018/19	2019/20
BASIC $	122	322	529	302	170	(721)
% change	5.6	14.0	20.2	9.6	4.9	n/a
OPTIONAL $	89	97	284	171	54	142
% change	9.0	9.0	24.1	11.7	3.3	163.0
COMBINED $	211	419	814	472	225	(580)
% change	6.7	12.4	21.4	10.2	4.4	(10.1)

Source: ICBC annual reports. FY2016/17 is April to March.

Table 5 shows that net injury claim costs decreased by almost 11%, while damage claims declined by 5.6%. In the 12-month period (current year incurred) the injury claims costs dropped 23.5%, partly offset by a planned increase in the no-fault accident benefits payments.

Table 5 – NET CLAIMS COSTS INCURRED ($=million)

	2018/19	2019/20	Difference	Per Cent
Net Claims Incurred				
Injury	4,854	4,327	(527)	(10.9)
Material Damage	1,675	1,581	(94)	(5.6)
Total	6,529	5,908	(621)	(9.5)
Current Year Incurred				
Injury	3,162	2,420	(742)	(23.5)
Accident Benefits	336	566	230	68.5
Total	3,498	2,986	(512)	(14.6)

Source: ICBC 2019/20 annual report p.26.

Material damage claims declined modestly, continuing a pattern begun in 2017/18. ICBC noted that the crash frequency had declined last year, but again it failed to provide actual numbers of injury or damage claims.

Table 6 – CURRENT YEAR MATERIAL DAMAGE CLAIMS ($=million)

	2018/19	2019/20	Difference	Per Cent
Basic Property Damage	643	611	(32)	(5.0)
Optional Collision	612	583	(29)	(4.7)
Comprehensive	195	202	7	3.6
Windshield	98	99	1	1.0
Total	1,548	1,495	(53)	(3.4)

Source: ICBC 2019/20 annual report p.28.

The Unpaid Claim Liability Continues to Grow

In the last five years ICBC has increased the reserve estimates to fund the cost of claims from prior years by $7.8 billion, with $5.1 billion earmarked for the compulsory Basic program and $2.7 billion for the Optional program. Practically all of these reserves are to fund injury claims.

Part of the explanation for the growth in the value of the unpaid claim liability is the decline in the interest rates during this period. Lower interest rates result in a lower discount rate applied to the anticipated future payments, which increases the cash requirement that must be reserved. For 2019/20 the discount rate was 2.9%, which compares to the 3.7% applied in 2018/19.

As interest and discount rates decline the market value of ICBC fixed income investments increases, acting as a counter-balance. This should be reflected in investment income and the change in the fair market value of these bonds.

Table 7 – UNPAID CLAIM LIABILITY ($=million)

	2014	2015	2016/17	2017/18	2018/19	2019/20
BASIC $	6,245	6,947	7,851	8,608	10,338	11,318
% change	9.1	11.2	13.0	9.6	20.1	9.5
OPTIONAL $	1,960	2,146	2,667	3,288	3,950	4,685
% change	9.4	9.5	24.5	23.3	20.1	18.6
COMBINED $	8,205	9,093	10,518	11,896	14,288	16,004
% change	9.2	10.8	15.7	13.1	20.1	12.0

Source: ICBC annual reports.

Between 2015 and March 2019 ICBC added 659 FTE positions (up 29%) to its claims division in an attempt to process more injury and property damage claims and restrain the growth in the value of the claim liability.[4] No information is available for 2019/20 as the government ordered the BC Utilities Commission to approve a zero Basic rate increase for April 2020 without the normal review.

SUMMARY

Despite the net loss and the negative equity, the results for 2019/20 are encouraging. Without the impact of the COVID-19 on the value of the equity investments the corporation would have finished the year in a much more healthy position. This was due to the cap on pain and suffering payments for minor injury claims, and a decline in the frequency (and number?) of crashes.

Since the year-end the equity markets have staged a rebound which should re-inflate the equity to some degree, but continuing lower interest rates will hamper a more rapid return to financial health.

The government ordered a four year suspension of the regulatory requirement for the Basic program to retain a minimum capital reserve. It has yet to indicate how it will assist ICBC to attain this capital reserve funding level.

The public reporting of our public auto insurer could be significantly improved if it would report even basic information on the number of policies sold, and the number and average cost of claims. Without this information the reader of the annual report has no context to form a proper understanding of the revenue and expenditures reported.

 September 1, 2020. http://www.bcpolicyperspectives.com/

[4] BCUC, ICBC 2019 RRA, IR1, RM 3.9 (pdf 791/1357); https://www.bcuc.com/Documents/Proceedings/2019/DOC_53549_B-2-ICBC-Responses-to-BCUC-Intervener-IR1.pdf