OCCASIONAL PAPER No. 82 ICBC

A CLOSER LOOK AT ICBC's REMARKABLE FINANCIAL REBOUND

1.0 THE FINANCIAL TURNAROUND

As of 1 December 2015, ICBC reported a healthy year-end equity of approximately $3.1 billion, which represented a Minimum Capital Test (MCT) ratio of 155%. By 31 March 2020, the public auto insurer, which enjoys a monopoly over the sale of Basic insurance, was technically insolvent, with negative equity of $547 million and an MCT of minus 30%.

In a remarkable turnaround, in February ICBC forecast a huge combined Basic and Optional insurance operating profit of $1.9 billion for 2021/22, with accumulated equity of almost $4.2 billion.[1] Thus, in just 24 months retained earnings had jumped by $3.0 billion, while the value of ICBC's assets had increased by $1.15 billion.

This paper will outline the primary reasons for the remarkable improvement in ICBC's financial condition. The focus will be comparing the actual revenues and expenditures for the last two fiscal years with what was planned/budgeted by ICBC. Detailed claims data for 2020/21 has recently been made available by ICBC, and this is incorporated into the review to further explain the improved results.

ICBC's Slide to Insolvency

A number of factors resulted in the deterioration in ICBC's financial condition from 2016/17 to 2019/20, with the most obvious being the significant increase in the number and average cost (severity) of both tort injury and vehicle damage claims costs. The Liberal government's pernicious 2013 decision to arbitrarily keep the increase in premiums below that required to cover the mounting claims costs (sometimes with the percentage change in double digits) led to major losses and a rapid depletion of the insurer's capital reserves. In effect, the government used policyholders' accumulated capital to subsidize premiums. This strategy worked until 2018/19, when the policyholders' capital all but vanished.[2]

[1] https://www.icbc.com/about-icbc/company-info/Documents/service-plan-2022-2025.pdf p. 21. Unfortunately, ICBC does not separate the compulsory Basic coverage from the Optional program results in its three-year service plans.

[2] In 2018/19 the combined equity was only $119 million, down from $3.1 billion as of 31 December 2015. An important reason for the large operating losses in 2018/19 and 2019/20 was the large increase to the reserves to cover prior years claims (see Section 2.5).

The Move to the No-Fault Liability Model

When the NDP government took office in July 2017 it aware that ICBC's finances were unsustainable.[3] In February 2018, the government announced its intention to change the governing legislation; effective 1 April 2019, awards for pain and suffering for a "minor" injury claim would be capped at $5,500, and all claim disputes up to $50,000 would be resolved by an expanded Civil Resolution Tribunal, rather than the Supreme Court. The intent was to lower the cost of injury claim settlements and to reduce the need for legal representation for most of the injury claims.[4]

Two years later the government announced that, commencing 1 May 2021, the hybrid-tort model would be replaced by an enhanced care/no-fault liability scheme modeled on the plan in place in Manitoba.[5]

Both the hybrid-tort liability model, and the subsequent no-fault (enhanced care) liability model, were designed to reduce the severity of injury compensation claims, although there may have been the expectation of fewer claims as well. Under the no-fault model the net savings after enhancing the benefits available to claimants were supposed to be enough to allow for an average 20% reductions in the combined Basic and Optional premium. The government also directed that some of the anticipated savings in the Basic program would be retained by ICBC to rebuild its decimated capital reserve.[6]

The COVID Complication

Any review of the impact of the changes to the injury liability model on ICBC's financial turnaround is complicated by the impact of the effects of the emergency measures instituted in March 2020 to slow the spread of the COVID-19 pandemic. These measures resulted in many fewer vehicles on the roads for much of fiscal year 2020/21, which coincides with the second year of the hybrid-tort model.

While the resulting reduction in the number of crashes reduced the cost of claims in 2020/21, ICBC did provide two rebates to policyholders totalling $950 million.

Also, over half of the negative equity recorded for 2020/21 can be attributed to the effects of the pandemic. For example, the international emergency measures announced in March 2020 led to an immediate sharp drop the value of equities on financial

[3] Minister responsible David Eby characterized the issue as a "dumpster fire," but this understated the problem.

[4] https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_feb_6_announcement_8_feb_2018/pdf/commentary_icbc_feb_6_announcement_8_feb_2018.pdf

[5] https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_no_fault_care_model_16_february_2020_2/pdf/commentary_no_fault_care_model_16_february_2020_2.pdf

[6] https://www.bcpolicyperspectives.com/media/attachments/view/doc/no_fault_announcement_6_february_2020_4/pdf/no_fault_announcement_6_february_2020_4.pdf

markets. This caused ICBC to book a $317 million impairment loss for 2019/20, which increased the operating loss to $376 million and worsened the negative equity. Equity markets regained much of the lost value within six months of the following fiscal year.

The Rebound in Net Income and Equity

In 2015, ICBC's combined accumulated equity was $3.6 billion, which was close to the capital management targets necessary for a satisfactory financial condition. However, with rising claims costs, and the arbitrary cabinet limitation on annual premium increases, the annual losses grew which resulted in a rapid decline in equity capital.

ICBC forecast that the 2019 change to the hybrid-tort model, featuring limits on pain and suffering payments, would improve net income by $1.0 billion over three years. In its 2018/19 to 2020/21 Service Plan, it forecast the corporate net income under the hybrid-tort model to be $80 million for 2020/21, compared to a status quo forecast of negative $920 million.[7]

Table xx shows the actual corporate net income for the last five years.[8] The dramatic increase in both the net income and equity during the last two years is apparent.

TABLE 1—COMBINED NET INCOME AND EQUITY ($=million)

		2017/18	2018/19	2019/20	2020/21	f2021/22
	Net Income (Loss)	(1,325)	(1,153)	(376)	1,538	1,904
	Equity	987	119	(547)	1,867	4,191

Source: 2017/18 to 2020/21 from ICBC annual reports, forecast 2021/22 is from ICBC 2022/23 to 2024/25 Service Plan. The 2021/22 equity forecast will be reduced by approximately $400 million to reflect the excess capital rebate announced in late March 2022

2.0 PRIMARY REASONS FOR THE REBOUND

Between 2020/21 and 2021/22 the cumulative net income totalled $3.4 billion, which was $3.0 billion more than ICBC budgeted for these two years. The actual equity recorded in both years was also much higher than was budgeted.

[7] https://www.icbc.com/about-icbc/company-info/Documents/Service-plan-2018-2021.pdf p. 18. The forecast was not repeated in the subsequent year's plan.

[8] The 2021/22 equity will likely decline by some $400 million to reflect the rebate announced on 25 March 2022.

2.1 Premium Revenue

Excluding the $950 million in COVID-19 rebates paid in 2020/21, during the last two years the actual premium revenue earned has been close to the budget forecast amounts. Changes in actual to budgeted net earned income were not a primary reason for the financial rebound.

The 2020/21 actuals were $1.29 billion lower than the budget due mostly to the $950 million in COVID-19 rebates returned to policyholders. This rebate in revenue reflects a good portion of the reduction in claims costs in that year resulting from fewer crashes and claims (see section 2.3).

2.2 Investment Income Up by $1.5 Billion

In the last two years, actual investment income exceeded the budget forecasts by almost $1.5 billion. This represents almost half of the $3.0 billion cumulative increase in the net income for the last two years.

The rapid increase in investment income was primarily due to gains on disposition of assets and the growth in the value of the equity segment of ICBC's investment portfolio (approximately 20% of the investment portfolio is equities), which reflects a general rise in the financial markets. For example, in its 2020/21 report the BC Investment Management Corporation reported a 44.5% return on the value of its Canadian public equities.[9]

2.3 Reduction in the Cost of Current Claims

Between 2020/21 and the forecast of 2022/23, the cumulative cost of current year claims were approximately $2.0 billion less than budgeted. Excluding $950 million in pandemic claims savings that were not budgeted in 2020/21, the net reduction in current year claims costs was approximately $1.0 billion.

Introduced in April 2019, the hybrid-tort liability model was designed to reduce the cost of bodily injury claims by limiting the payment for pain and suffering for minor injury claims. Table 2, Line 2 shows the actual current year claims costs peaking in 2018/19, then declining by almost 11% for 2019/20.

The forecast actuals for 2021/22, which mostly reflects the no-fault model, is only some 3% less than the prior year. However, the prior year's claims costs are abnormally low because of the pandemic impact reducing the number of claims.

TABLE 2—CURRENT YEAR CLAIMS COSTS ($=million)

		2017/18	2018/19	2019/20	2020/21	2021/22
1	BUDGET	4,719	6,038	5,499	5,384	3,939
2	ACTUAL	5,084	5,308	4,728	3,708	f3,605

[9] https://www.bci.ca/wp-content/uploads/2021/07/F2021-Corporate-Annual-Report.pdf p. 29.

3	VARIANCE	365	(730)	(771)	(1,676)	(334)
4	CHANGE %	7.7%	(12.1)%	(14.0)%	(31.1)%	(8.5)%
5	CHANGE in ACTUAL %	10.3%	4.4%	(10.9)%	(21.6)%	(2.8)%

Source: Budgets from ICBC service plans and actuals from annual reports; the forecast actual for 2021/22 is from the 2022/23 to 2024/25 Service Plan.

Table 2 also compares ICBC's budget forecast (Line 1) and the year-end actuals (Line 2). Excluding the 2020/21 pandemic impact, ICBC has been overstating its forecast for current year claims costs since 2018/19. For 2022/23, ICBC has budgeted for a 14.5% increase in the 2022/23 current year claims costs compared to the forecast actuals for 2021/22. ICBC did not justify this increase in its service plan budget.

2.4 Number of New Claims

The primary intent of the elimination of the full tort liability model was to reduce the net cost of injury claims,[10] although a reduction in the actual number of claims may have been anticipated because of the elimination of the payment for pain and suffering. Table xx shows that Basic injury claims declined significantly in 2018/19, a year before the introduction of the hybrid-tort liability.

The major reduction in both injury and property damage claims in 2020/21 likely reflects the impact of the measures to combat the spread of the pandemic. Fewer vehicles on the road resulted in fewer crashes and claims.

TABLE 3—NUMBER OF NEW BASIC CLAIMS

		2017/18	2018/19	2019/20	2020/21
	INJURY CLAIMS	50,025	47,997	41,531	27,306
	Change %	5.6%	(4.1)%	(13.5)%	(34.3)%
	PROPERTY DAMAGE	161,180	149,934	139,230	99,910
	Change %	12.0%	(7.0)%	(7.1)%	(28.2)%
	COMBINED	211,205	197,931	180,761	127,216
	Change %	10.5%	(6.3)%	(8.6)%	(29.6)%

Source: ICBC response to FOI request CFT 315501 of March 1, 2022.

In its 2020/21 annual report ICBC stated that there were 30% fewer crashes due to the effects of the pandemic.[11] This is shown in Table 3 for the combined new injury and

[10] Savings from the elimination of pain and suffering and the legal transaction costs were redirected to improved benefits and a reduction on premium rates for 2021/22.
[11] https://www.icbc.com/about-icbc/company-info/Documents/ar-21.pdf P. 8.

property damage claims. Of interest is the fact that both injury and property damage claims began to decline in 2018/19, before the change to the hybrid-tort liability model in 2019 and the full effects of the pandemic in 2020.

2.5 Reduction in the Provision for Prior Years Claims

Each year ICBC adjusts the funding reserved to settle claims from prior years. An increase to the reserve will add to total costs, while a decrease will reduce costs. Table 4 shows that between 2020/21 and the forecast for 2021/22, ICBC reduced the allowance for prior years claims by some $700 million compared to the budget. This compares with a $2.45 billion increase in the actual to budget variance for the prior two years.

TABLE 4—ADJUSTMENT TO PRIOR YEAR CLAIMS ($=million)

	2017/18	2018/19	2019/20	2020/21	2021/22
BUDGET	(63)	(76)	29	44	(101)
ACTUAL	563	1,221	1,180	(367)	f(387)
VARIANCE	626	1,297	1,151	(411)	(286)

Source: Budgets from ICBC service plans and actuals from annual reports; the forecast actual for 2021/22 is from the 2022/23 to 2024/25 Service Plan.

In its annual reports ICBC justified the large increase in actual adjustments for 2018/19 and 2019/20 as higher than estimated costs to settle tort claims. A decline in the claim liability discount rate in 2019/20 also contributed to the higher adjustment.

Presumably, ICBC's actuaries lowered the claims reserve requirement in 2020/21 and 2021/22 to reflect recent actual settlement costs. Table 5 shows the average injury and property damage claim cost (severity) for completed claims. All completed or settled injury claims were full tort until 2019/20 when some of the hybrid-tort claims would have been included in the settled totals.

TABLE 5—AVERAGE COMPLETED BASIC CLAIM SEVERITY ($)

	2017/18	2018/19	2019/20	2020/21
INJURY CLAIMS	41,810	44,056	42,752	37,464
Change %	8.9%	5.4%	(3.0)%	(12.4)%
PROPERTY DAMAGE	4,015	3,959	4,149	4,599
Change %	16.0%	(1.4)%	4.8%	11.7%

Source: ICBC response to FOI request CFT 315501 of March 1, 2022. Writer's average from numbers supplied.

Over time, the tort claims will be reduced to zero and replaced by the no-fault claims. It is anticipated that there would be far fewer no-fault claim disputes during the next few years due to the increased benefit limits and the elimination of pain and suffering as a basis for a claim. This will reduce the volatility in the amounts for prior years claims.

2.6 Other Expenditure Components

Changes between the actual and budgeted expenditures in the other major cost components (such as Claims Service, Administration, Taxes and Commissions and Driver Licensing) showed a two-year savings of approximately $180 million.

3.0 SUMMARY

In general, the primary reasons for the positive financial variance between the actual and the budgeted operating income for 2020/21 and 2021/22 were a major improvement in investment income, a significant reduction in current year claims costs and a reduction in the provision for prior years claims. The reduction in claims costs appear to relate to the elimination of the full tort liability model beginning in April 2019, however the pandemic-related reduction in claims costs complicates the analysis.

The rapid growth in policyholders' equity during the last two years was due to the growth in the net income, as well as a significant increase in the fair market value of ICBC's investments (Other Components of Equity).

ICBC was not alone in recording an improved financial picture. As recently reported in *The Canadian Underwriter* magazine, in 2021 the auto insurance sector enjoyed a marked improvement in profits and return on equity.[12] While the investor-owned insurers have seen their capital levels (or share buy backs) increase, ICBC and the public insurers in Manitoba and Saskatchewan have returned some of the excess capital to policyholders.[13]

Clearly, the marked improvement in ICBC's net income resulted from the abandonment of the tort liability model, and some extraordinary investment gains. Looking ahead it is unlikely that these large increases will be repeated. The major gains from the change to the no-fault model have been achieved, and the tightening of financial markets will limit gains in equity valuations.

 https://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 is an intervener in the BC Utilities Commission's recent reviews of ICBC's and B.C. Hydro's rate requests.

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[12] https://www.canadianunderwriter.ca/insurance/how-auto-could-be-the-force-that-eats-into-canadian-insurers-results-1004220099/

[13] https://www.bcpolicyperspectives.com/media/attachments/view/doc/commentary_icbc_rebate_27_march_2022/pdf/commentary_icbc_rebate_27_march_2022.pdf