The Decline and Fall of ICBC

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FRASER INSTITUTE

2018

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Executive Summary

The Insurance Corporation of British Columbia (ICBC) experienced a horrible financial year in 2016–17. It suffered its largest ever annual loss of $889 million, an amount equal to 18 percent of its total premiums, and it is heading for a $1.3 billion loss in 2017– 8, which would represent 23 percent of its revenue from premiums. The corporation's claim costs have risen, its investment income has shrunk, and its revenue from premiums has not kept pace.

In the past, losses on ICBC's basic business, mandatory coverage, have been relatively common and were offset by transfers from its optional business. Without these transfers, the basic business's capital would have fallen below the regulatory minimum. However, these transfers are no longer possible because the optional business has suffered a loss. Moreover, they have proved to be insufficient to deal with ICBC's financial problem. Together with transfers to the provincial government, they have taken $2.5 billion of capital from ICBC's optional business, threatening its sustainability.

ICBC's basic business has been a victim of both an unfriendly environment and misguided provincial government policies. The unfavourable environment arises from both a higher frequency and greater severity of claims. Higher costs resulting from more vehicles on provincial roads and greater congestion are largely beyond ICBC's control. Some cost pressures, however, may be controllable. Reduced enforcement may have increased the frequency of accidents, while ICBC's procedures for assessing property damage claims may have raised the costs of those claims.

But cost escalation is only part of the story. The provincial government's rate smoothing mandate has harmed ICBC's basic business. Without this requirement, ICBC could have raised rates to reflect the increasing costs and in so doing preserved its finances. Customers would not have welcomed these rate increases, but they would have saved ICBC from having to make much larger increases in the future.

The transfers from the optional business to the basic business were never more than a band-aid. They have masked the underlying problems in ICBC's basic business and delayed the adoption of remedial measures.

ICBC's condition is now so unhealthy that the attorney-general has been forced to suspend the government's minimum capital requirement. The task of restoring ICBC's financial viability requires that a substantial capital shortfall be overcome and the soundness of its insurance operations restored.

ICBC differs from private insurers in one important respect. Private insurers can and do fail without a substantial impact on the auto insurance market because other insurers can move in to take over their business. Were ICBC to fail, it would be much more damaging because of its size (its annual premiums total over $5.0 billion) and because it is the only supplier of compulsory (basic) insurance in British Columbia.

ICBC's financial position is unsustainable. The current government deserves credit for bringing the issue forward and seeking informed advice. Band-aid solutions will not be enough to fix its problems. ICBC's role must be rethought, as must the objectives and role of government in the insurance business. Should ICBC be treated as a purely commercial concern, or should it instead continue to serve as an instrument of government policy? If the latter, then how can these activities be sustained while maintaining ICBC's financial soundness? These are questions subsequent research papers will seek to answer.

1. Introduction

The Insurance Corporation of British Columbia (ICBC) experienced a horrible financial year in 2016–17. It suffered its largest ever annual loss of $889 million, an amount equal to 18 percent of its total premiums, and it is heading for a $1.3 billion loss in 2017– 8, which would represent 23 percent of its revenue from premiums. The BC government is forecasting losses of $1.078 billion for 2018/19 and is expecting net losses of $800 million in 2019/2020 and $920 million in 2020/2021, even taking possible reforms into account (British Columbia, Ministry of Finance, 2018). While losses on its basic business have been relatively common in the past, in 2016–17 ICBC realized a loss on its optional business. As a result, its optional business can no longer "bail out" its basic business as it has previously.

These losses raise questions about ICBC's future viability. Are they a result of extraordinary circumstances that can be readily reversed, or do they reflect a continuing deterioration in the state of ICBC's finances? This paper focuses on the changes in ICBC's financial condition that have led to the current crisis.

The paper is organized as follows. Section 2 profiles ICBC's operations. Section 3 provides a snapshot of ICBC's recent performance. The following sections examine ICBC's poor performance in some depth. Specifically, section 4 assesses the consequences of the government-set limits on rate increases for ICBC's basic business, section 5 reviews the evolution of ICBC's investment income, and section 6 deals with the sources of ICBC's increased costs. Section 7 examines the adequacy of ICBC's capital and the impact of its current operations on its capital level. The final section concludes.

2. ICBC's Profile

The Insurance Corporation of British Columbia was created in 1973 as a crown corporation to provide automobile insurance in the province. As a public insurer, ICBC has been expected to offer stable and affordable rates, apply rate assessments based on driving and claims history rather than demographic characteristics and place of residence, and supply additional services on behalf of the provincial government (Ernst & Young, 2017: 37).

ICBC has a monopoly on providing Basic Autoplan (basic insurance), a coverage package that is mandatory for all motor vehicles registered in the province. ICBC also offers optional insurance to provide vehicle owners with coverage beyond the basic package. It has no monopoly on this optional insurance, which it offers in competition with private insurers.

Basic insurance includes the following coverages:

- Third party liability: up to $200,000 for injury costs and vehicle damage
- Accident benefits: up to $150,000 in medical and rehabilitation to drivers and passengers regardless of fault
- Uninsured motorist protection
- Hit and run damage and injuries: up to $200,000
- Inverse liability protection: coverage in Canada and the US where local laws do not permit claims against at-fault drivers
- Wage loss: 75 percent of gross weekly earning up to $300 per week with offsets for other sources of benefit
- Funeral: $2,500 for burial and funeral expenses
- Variable death benefits (Ernst & Young, 2017: 35).

The government has further directed that ICBC's premium rate structure for basic insurance include the following public policy objectives:

- A seniors' rate class for pleasure use with a 25 percent discount, introduced in 1976
- A disability discount introduced in 1977

- A claim-rated scale introduced in 1981 that bases premiums on driving and claims experience rather than age, gender, and marital status.
- Differentiated rates according to territory to reflect fairness and changes in risk characteristics (Ernst & Young, 2017: 35).

The corporation is also responsible for providing, at its own expense, various non-insurance programs and services. At times the provincial government has directed ICBC to make transfers from its optional account to the provincial government's general revenue fund.

Rate regulation

Until 2003, the BC government's cabinet reviewed and approved both ICBC's rate design and the rates charged on its basic business. Since then, the review and approval of ICBC's rates have been assigned to the British Columbia Utilities Commission (BCUC). Nevertheless, the government has maintained its authority by issuing special directives that limit the commission's actions. IC1, the initial directive, required that approved rates for compulsory insurance were to cover ICBC's costs for responsibilities prescribed by the government for road safety, driver and vehicle licensing, commissions paid to agents for collecting government fees and other revenue, in addition to costs arising from its insurance coverage.

The government's mandate for the BCUC was extensively modified in 2004 by replacing Directive IC1 with Directive IC2. This new directive stipulated that ICBC's optional business was to operate on a break-even basis. Subsequently net income has been used for transfers to ICBC's basic business and to the provincial government. The government also made it clear that the BCUC would not play any role in setting ICBC's rates for optional insurance.

Directive IC2 was amended in 2013 to further limit BCUC's powers to approve ICBC's rate requests. The amendment meant BCUC could only approve annual rate changes for basic insurance of 1.5 percent or less.

Capital regulation

Directive IC2 also recognized that insurers need to maintain capital so they can meet their claims when conditions are unfavourable. Further, it extended the BCUC's responsibility to ensuring that ICBC achieved and maintained a target capital level by 2014. Subsequent amendments to Directive IC2 directed BCUC to authorize income and capital transfers out of

ICBC's optional business to make up any deficiency that arose when the basic business's capital fell below its mandated level.

ICBC and the provincial budget

The net earnings of ICBC, like those of other self-supported Crown corporations, are included in the provincial government's Consolidated Statements of Operations. This inclusion does not necessarily represent any transfer from ICBC to the provincial government. While no such transfers have been made from ICBC's Basic account, transfers from the Optional account to the provincial government have been regular, totalling $1,090 million in five of the past seven years.

3. ICBC's Financial Performance: 2008 to 2017

ICBC is in a critical financial condition. With revenues of $5.4 billion and costs of $6.0 billion, it suffered a $600 million loss in 2016–17[1] (figure 1a).[2] This loss reflects a substantial worsening in the corporation's financial condition: it was once a financially viable enterprise that in the past has experienced net income as high as $300 million.

The financial experiences of ICBC's basic and optional businesses have differed substantially over the years. Its basic business has never had more than $200 million net income and has suffered losses in three of the last seven years (see figure 1b). In contrast, its optional business averaged an annual net income greater than $300 million up to 2016–17 when it suffered a $265 million loss (figure 1c).

ICBC's poor 2016–17 results cannot be dismissed as a one-time set back. Rather, they reflect a continuing deterioration. The financial condition of the corporation's basic business has been poor for a number of years while its optional business has supported its overall performance. Now its optional business has also suffered a loss.

[1] The financial year 2016-17 covered 15 months because of a change in ICBC's fiscal year to make it correspond to that of the government. Accordingly, the numbers used for 2016–17 have been adjusted throughout the paper to be comparable to the 12-month results of earlier years.

[2] These figures do not include transfers between ICBC's optional and basic accounts and between the optional account and the BC government.

Figure 1a: ICBC Overall: Revenues and Costs ($ billions)

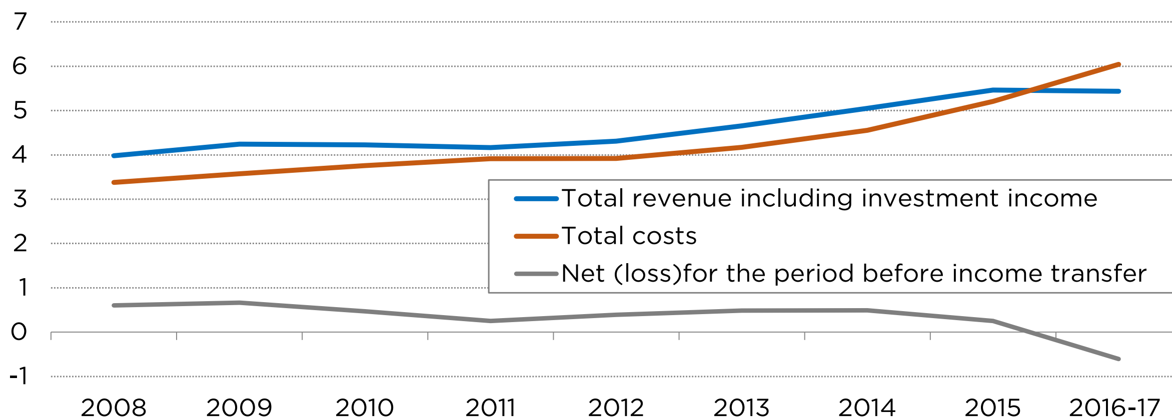


Figure 1b: ICBC Basic: Revenues and Costs ($ billions)

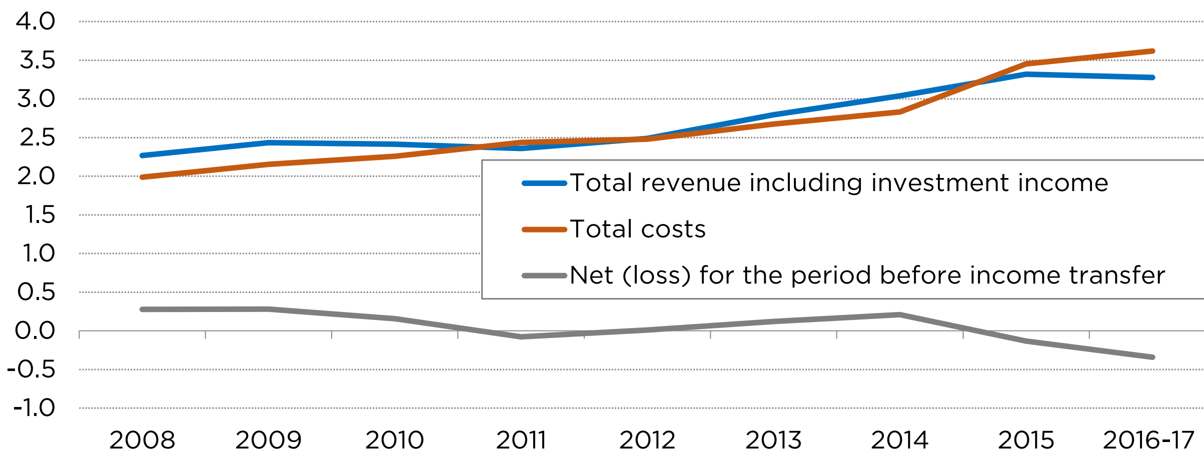
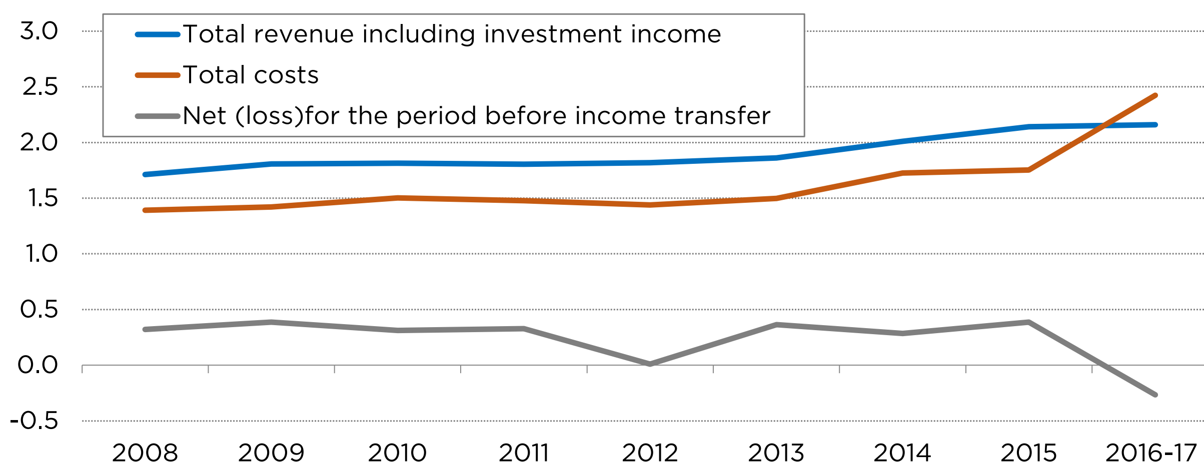


Figure 1c: ICBC Optional: Revenues and Costs ($billions)



Source: ICBC, various years (b): Applicaton for Revenue Requirements.

4. The Influence of Rate Smoothing on ICBC's Performance

The BC government's Special Directive IC2 issued in 2009 required ICBC "to establish a framework for rate stability" in order moderate changes in the premiums for basic business. While the framework was indicative at first, the directive became prescriptive when the government modified the directive to limit changes in year-to-year premiums for 2014 and following years to be no more than 1.5 percent. Any resulting shortfall in ICBC's revenues relative to its costs was to be made up by drawing on its capital accounts or through transfers from the optional account. If these transfers were sufficient, rates changes could be held below the 1.5 percent ceiling.

Such rate smoothing can be manageable when required rates have an underlying stable trend. In this case, the shortfalls from the limits on rate increases in years where revenues fall short of costs can be made up in years when revenues exceed current costs.

But the situation is different when costs are rising. Then, the shortfalls can become cumulative. A deficiency in one year will persist into the next and be added to the previous shortfall. In this situation, restoring the insurer's financial condition requires that the rate increase must cover not only the cumulative shortfall but also the run-down of capital from the previous shortfalls.

From 2004, when the BCUC was tasked with approving rates through to 2012, it tended to approve ICBC's requests for changes that would cover the insurers' costs with little modification (table 1). This practice changed markedly for 2013 when ICBC proposed a basic rate change of 4.9 percent, well below the 11.5 percent required to cover costs; BCUC ended up approving a rate increase of 5.2 percent for 2013, 0.3 percentage points above ICBC's request, but not enough to make up the difference between revenues and costs.

The rate stability framework of Special Directive IC2 affected the approved rate again for 2015 when ICBC applied for a 5.5 percent rate increase that fell below the increase (11.2 percent) needed to cover costs by 5.7 percentage points. In response, the BCUC approved a 5.5 percent increase, again requiring the difference to be made up from basic capital and

Table 1: Rate Changes for Basic Coverage

Forecast year	Rate change to cover costs	Rate change requested	Rate change approved	Revenue shortfall from cap on rate increases
2004		1.3%	0.4%	
2005		0.0%	0.0%	
2006		6.5%	6.5%	
2007		3.3%	3.3%	
2008		0.0%		
2009		0.0%		
2010		-2.4%		
2011		0.0%		
2012		11.2%	11.2%	
2013	11.5%	4.9%	5.2%	n/a
2014	-1.4%	5.2%	5.2%	
2015	11.2%	5.5%	5.5%	$115 million
2016	13.6%	4.9%	4.9%	$300 million
2017	20.0%	6.4%	6.4%	$415 million

Source: ICBC, various years (b).

transfers from the optional account. Similarly, the approved rate increase for 2016 was held to 4.9 percent, leading to deficiency of 8.7 percentage points. The application for 2017 was the first to reflect the full 1.5 percent ceiling on rate increases mandated by the provincial government and required transfers of $658 million from ICBC's optional business to keep the rate within the 1.5 percent boundary.

The BC government's introduction of the rate smoothing framework for ICBC's basic business has led to substantial revenue shortfalls relative to costs. The expected extent of these shortfalls reached $115 million in 2015, $300 million in 2016, and an anticipated $415 million in 2017.

The government's imposition of rate smoothing has turned out to be misguided. It has prevented ICBC from adjusting its rates to match its escalating costs and caused it to dip into both its basic and optional capital. The resulting losses from the rate cap are bound to increase each year that the rate smoothing mechanism remains in place.

5. Investment Income

Investment income is a source of revenue for ICBC and other insurers that helps to cover claims and operating costs (table 2). ICBC's investment income grew steadily from $281 million in 2012 to a peak of $607.8 million in 2015 and then fell in 2017 to just 55 percent of the previous year's level.

Table 2 shows that the contribution that investment income makes to covering claims and operating costs rose from 7 percent in 2012 to a peak in 2014 and 2015 when investment income contributed 12 percent of these costs. Since then, the contribution of investment income has fallen by half to just 6 percent, worsening ICBC's financial condition.

The performance of investment income in the past few years does not bode well for the future. It now covers a lower proportion of ICBC's costs than in the recent past. The decline in investment income reflects a decline in both investment assets arising from past operating deficits and the return earned on these assets. While the return on assets may recover, any recovery of investible assets would depend on ICBC reversing the deficit on its underwriting activity, something that appears unlikely under current conditions.

Table 2: Contribution of Investment Income

	2016/17	2015	2014	2013	2012	2011
Investment income ($ millions)	332.4	607.7	564.7	437.4	280.9	278.4
Claims and other costs ($ millions)	6,042	5,208	4,556	4,171	3,918	3,912
Investment income/ claims and other costs	5.5%	11.7%	12.4%	10.5%	7.2%	7.1%

Source: ICBC, various years (b).

6. ICBC's Costs

Both ICBC's management and Ernst & Young have stressed the role that escalating costs have played in ICBC's financial problems. ICBC's costs totalled $6.0 billion in in 2017, 60 percent of which of came from its basic business (table 3). Though some of the increase in ICBC's total costs from 2012 to 2017 resulted from a higher number of policies, the costs per policy increased over the period by 40 percent, from $1,173 to $1,638, with the fastest growth occurring in the later years.

Table 3: Frequency of Claims and Cost Per Claim: Basic

Type of claim	Incidence	
	Bodily injury	Property damage
2012	2.8%	11.9%
2017	3.3%	12.1%
Change	18.7%	2.0%
Cost per claim		
2012	$42,571	$2,767
2017	$45,081	$3,480
Change	$2,510	$713
Total cost (millions)		
2012	$1,620	$447
2016/17	$2,405	$681
Change	48.4%	52.3%

Sources: ICBC, various years (a): Appendix C1—Frequency Summary and Appendix C2—Severity Summary; and author's calculations.

Table 4: Influences on the Increase of ICBC's Claim Costs: 2012-2017

Source	Bodily injury	Property damage	Other[1]
Increased incidence	57.8%	1.7%	0.0%
Cost per incident	18.2%	22.1%	0.2%

[1]Other includes medical rehabilitation, weekly benefits, and death benefits.

Sources: ICBC, various years (a): Appendix C1—Frequency Summary and Appendix C2—Severity Summary; and author's calculations.

Claims costs have been the fastest growing expense, increasing by 61 percent between 2012 and 2017 compared to the 31 percent increase in other costs. Different types of claims have contributed to ICBC's costs to varying degrees according to their frequency and shifts in the size of the claims.

Claims for property damage are the most common type of claim followed by claims for personal injury. In terms of costs per claim, the $45,000 cost per personal injury claim far exceeds the cost for any other type of claim. Overall, personal injury claims are greater than all the other claims combined.

Since 2012, the incidence of bodily injury increased by 18 percent, while the incidence of property damage increased by just 2.0 percent. In terms of severity, the $2,510 increase for personal injury also exceeded the $713 increase in property damage claims.

More important than the size and growth of different categories of claims is their contribution to the increase of ICBC's aggregate claim costs. Table 4 shows that bodily injury was the largest contributor to ICBC's rising costs from 2012 to 2017 with its increased incidence accounting for 57.8 percent of the total cost increase. The increased cost per incident from property damage was the next largest contributor, accounting for 22.1 percent of the increase, followed by the increased cost per incident of bodily injury at 18.2 percent.

Explanations for cost increases

The increase in claims costs can occur for a number of reasons, including an increase in congestion from more vehicles on the roads, deterioration in driving standards, higher prices for labour and materials, and less stringent enforcement of traffic laws. ICBC itself suggests that the greater number of registered vehicles and the resulting heightened congestion has increased the frequency of accidents, an explanation that gains some support from the across-the-board increase in the incidence of the major categories of claims.

Factors other than increased congestion may have also contributed to the increased frequency of claims. A report from Ernst & Young (2017) shows that enforcement efforts for traffic violations have fallen from 2013 to 2015 despite the increase in licensed vehicles. Table 5 shows that the number of tickets issued have decreased by over 10 percent for speeding and distracted driving, while sanctions and criminal code charges for impaired driving have decreased even more sharply—by 17 percent and 38 percent, respectively.

Table 5: Summary of Tickets, Issued Sanctions and Code Charges Issued

	Speeding	Distracted driving	Impaired driving		Total
Year	Tickets issued			Criminal code charges	
2013	184,000	66,000	30,000	860	280,860
2014	176,000	66,000	28,000	730	270,730
2015	164,000	59,000	25,000	530	248,530
% change 2013-2015	-10.9%	-10.6%	-16.7%	-38.4%	-11.5%

Source, Ernst & Young, 2017: 92.

ICBC and MoveUP, the union representing ICBC's workers, offer differing explanations for the increased cost per claim for property damage. ICBC suggests that property damage claims have become more expensive because of the increased costs of parts and equipment. MoveUP, on the other hand, argues that ICBC's claims process allows customers to get estimates from body shops that are then passed on to ICBC for approval. A vice-president of MoveUP claims that the high volume of claims prevents ICBC estimators from doing checks and making sure the body shops are accountable (Mendoza, November 1, 2018). Auto shops, on the other hand, claim that the rising cost of auto repairs has contributed to the increase (Mendoza, November 1, 2018).

The MoveUP position gains some support from Statistics Canada's measures of price increases for passenger vehicle parts and maintenance from 2012 to 2017. Table 6 shows that the price indexes for passenger parts and accessories and the index for repair services increased by 1.9 percent and 9.8 percent respectively in a period when ICBC's cost per claim for property damage increased by a much larger 26 percent.

Table 6: Change in Costs of Vehicle Parts and Maintenance, 2012-17 (2012 = 100)

	July, 2012	June, 2017
1. Passenger vehicle parts, accessories and supplies	100	101.9
2. Passenger vehicle maintenance and repair services	100	109.8

Source: Statistics Canada, *Consumer Price Index*, series v1691138 and v1691139; and author's calculations.

7. Capital Management

Capital is a vital for insurers; it allows them to meet their claims even when conditions are unfavourable. The target level of capital for ICBC is governed by regulatory requirements that set a minimum level of capital as well as management decisions to hold capital levels above the regulatory minimum.

Capital for basic business

Special Directive IC2 from 2004 initially set the minimum level for "available capital" equal to at least 110 percent of the "Minimum Capital Test" (MCT) measure used by the federal Office of the Superintendent of Institutions (OSFI). This level was subsequently reduced to 100 percent for 2010. Because ICBC's basic insurance business is a monopoly and does not face risks from competition**,** the capital level required for basic insurance has intentionally been set below OSFI's requirement for federally regulated insurance companies.

In practice, the capital needed to meet the requirement comes from ICBC's surplus, its retained earnings, and certain reserves. The capital required for the test depends on the various risks faced by the insurer, including insurance risks and market risk, among others.

Table 7 shows the level of capital required by Special Directive IC2 for ICBC's basic business together with the internal capital targets set by ICBC's management. By 2009, the internal target had been set at 180 percent of MCT and then fluctuated in a narrow range between 170 and 185 percent.

ICBC's actual capital reached a peak of 240 percent of the MCT in 2009, well before the date required by Special Directive IC2, and then dipped down in 2010 and again in 2014 because available capital did not grow as fast as the insurance coverage in force.[3] The loss in 2011 put fur-

[3] The MCT ratio can change because of changes in the level of capital arising from changes in net income or changes in the level of insurance coverage written, which in turn determines the change in the required capital. Even if capital increases, the MCT ratio can fall if the insurance increases proportionately more.

Table 7: ICBC's capital position: Basic business

	IC2 requirement relative to MCT	Internal management target	Actual capital (reported in year)
2009	110%	180%	240%
2010	100%	170%	218%
2011	100%	170%	189%
2012	100%	175%	200%
2013	100%	175%	204%
2014	100%	185%	193%
2015	100%	185%	157%
2016/17	100%	185%	Not reported
2018	Requirement suspended		

Source: ICBC, various years (a); author's calculations; and Hunter, February 27, 2018.

ther downward pressure on ICBC's capital for its basic business. Pressure from losses intensified in 2015 when ICBC's MCT ratio fell by 35 percentage points, from 193 percent in 2014 to 157 percent. The fall in the MCT persisted in 2017 when a $340 million operating loss pushed the estimated MCR ratio below 100 percent.

Although ICBC did not report its MCT ratio in its 2017 *Statements and Schedules of Financial Information*, in a response to an information request from Richard McCandless, it revealed that a $470 million transfer to capital would be required to maintain the MCT ratio above the 100 percent minimum (British Columbia Utilities Commission, 2017: 2017.1 RR RM.1.6). It further indicated that annual capital transfers averaging over $500 million would be required to maintain minimum capital levels in the years up to 2021.

ICBC also forecast that in the absence of any additional capital transfers, its MCT ratio would fall to 61 percent in 2018, a level below the required minimum, and continue to fall in the following years. ICBC's capital for its basic business would be totally exhausted by 2021, giving an MCT ratio of -4 percent. In February 2018, BC's attorney-general took the extraordinary step of suspending ICBC's capital requirement (Hunter, February 27, 2018; British Columbia, 2018). Without this action, ICBC would have been technically insolvent from a regulatory perspective.

Table 8: Capital Transfers from Optional Coverage ($ millions)

	From income		From equity	
	1	2	3	4
	To basic business	To province of BC	To basic business	To province of BC
2017	$161		$497	
2015	$256			$138
2014		$139		
2013	$113	$237		
2012	$373			
2011		$101		
2010				$575
Total	$903	$477	$497	$713

Source: ICBC, various years (a).

Optional business capital

For competitive reasons, ICBC does not report its capital position for its optional business. Still, some indication of its capital position can be gained by using its equity-to-claims ratio. This measure is conceptually similar to the MCT ratio and compares the value of equity on ICBC's balance sheet with its cost of claims in any year.

The equity-to-claims ratio on ICBC's optional business remained well above 1.0 for the years through 2015. The situation deteriorated sharply in 2017 when losses pushed the ratio below 1.0, to a level of just 0.7.

Capital and income transfers

The provincial government has mandated at various times that ICBC make capital and income transfers from its optional business to its basic business—and to the provincial government itself. Table 8 shows that the transfers have totalled almost $2.6 billion since 2010. These transfers have

Table 9: ICBC's Capital Position: Basic Business

	1 Actual capital ratio (reported in year)	2 Equity-to-claims ratio	3 Equity-to-claims ratio excluding current transfers from optional business	4 Difference between (3) and (2)	5 Equity-to-claims ratio excluding cumulative transfers from optional business	6 Difference between (5) and (2)
2009	240%	0.93	0.93	0%	0.93	0%
2010	218%	0.95	0.95	0%	0.95	0%
2011	189%	0.58	0.58	0%	0.58	0%
2012	200%	0.69	0.51	-26%	0.51	-26%
2013	204%	0.79	0.74	-6%	0.56	-29%
2014	193%	0.71	0.71	0%	0.30	-58%
2015	157%	0.41	0.31	-24%	0.13	-68%
2017	Not reported	0.47	0.26	-45%	0.02	-96%

Source: ICBC, various years (b); and author's calculations.

substantially altered the capital positions of both ICBC's basic and optional businesses.

Impact of transfers on basic capital

The capital position of the basic business has been bolstered by income and capital transfers from the optional business as a result of Special Directive IC2's requirement that sufficient capital be transferred to the basic account whenever the MCT lies below the regulatory minimum. These transfers took place in 2012, 2013, 2015, and 2017, and have totalled $1.4 billion.

Table 9 shows the degree to which these capital transfers have bolstered the capital position for ICBC basic business using the equity-to-claims ratio as a measure.[4] Column 2 of the table shows the equity-

[4] The equity claims ratio is used as a measure because of the availability of data to make adjustments for capital transfers. This measure on an unadjusted basis (column 2) shows a similar pattern to the capital position on basic business (column 1).

to-claims ratios after current-year transfers of capital from the optional accounts, while column 3 shows the ratio for each year with the current year's transfer removed. Column 5 shows the ratio in absence of all the capital transfers up to that year.

The results of the adjustments for current-year transfers show that the equity-to-claims ratio would have fallen below the actual by 22 percent in 2012, 9 percent in 2013, 24 percent in 2015, and 45 percent in 2017. By this measure, the decline in ICBC's basic capital would have been much sharper: the unadjusted equity-to-capital ratio declined by 49 percent from 2009 to 2015, while in absence of capital transfers, the ratio would have declined by over 72 percent.

The adjustment for current capital transfers understates the actual contribution of the transfers to the basic account capital because reported capital at any time reflects the cumulative impact of past transfers. Adjusting for cumulative capital transfers shows a grimmer picture. The adjusted equity-to-claims ratio falls below the unadjusted level by much larger amounts from 2013 onward. The adjusted capital-to-equity ratio by this measure would have been 98 percent below its unadjusted level.

Impact of transfers on optional capital

While capital transfers have bolstered ICBC's basic capital, they have depleted the capital of its optional business (see table 10). The actual equity-to-claims ratio for the optional business after the transfers indicates that the equity-to-claims ratio has declined steadily by 68 percent, from 2.2 in 2009 to just 0.7 in 2017.

Adjustment for current-year transfers to the basic business shows the optional equity-to-claims ratio would have been higher by 5 to 66 percent, with the largest difference recorded in 2017 (table 10a). With this adjustment, the equity-to-claims ratio would have declined by 57 percent over the period, just four-fifths of the decline of the unadjusted ratio.

Adjustments for cumulative transfers to the basic business would raise the equity-to-claims ratio by more each year with an adjustment up to up to 141 percent in 2017. Overall, these adjustments show that the equity-to-capital ratio for the optional business would have been well above unity for all years in the absence of the transfers mandated by the provincial government. In addition, the decline of the equity-to-capital ratio for the optional business would have been just 23 percent, just one-third that of the unadjusted ratio.

A more extreme picture appears when the transfers to the basic business together with the transfers to the provincial government (table

Table 10a: Effects of Transfers on Capital of ICBC's Optional Business — Transfers to Basic Business

Policy year	1	2	3	4	5
	Equity-to-claims ratio before transfers	Equity-to-claims ratio with current transfers to basic business added back	Difference between (2) and (1)	Equity-to-claims ratio with cumulative transfers to basic business added back	Difference between (4) and (1)
2009	2.2	2.2	0%	2.2	0%
2010	1.8	1.8	0%	1.8	0%
2011	1.9	1.9	0%	1.9	0%
2012	1.9	2.3	21%	2.3	21%
2013	1.9	2.1	11%	2.4	26%
2014	1.8	1.8	0%	2.3	28%
2015	1.8	2	11%	2.4	33%
2017	0.7	1.2	71%	2.7	286%

Source: ICBC, various years (a); and author's calculations.

Table 10b: Effects of Transfers on Capital of ICBC's Optional Business — Transfers to Basic Business and to Government

Policy year	1	2	3	4	5
	Equity-to-claims ratio before transfers	Equity-to-claims ratio with current transfers to basic business and to government added back	Difference between (2) and (1)	Equity-to-claims ratio with cumulative transfers to basic business and to government added back	Difference between (4) and (1)
2009	2.2	2.2	0%	2.2	0%
2010	1.8	2.4	33%	2.4	33%
2011	1.9	2.0	5%	2.6	37%
2012	1.9	2.3	21%	3.0	58%
2013	1.9	2.3	21%	3.4	79%
2014	1.8	2.0	11%	3.3	83%
2015	1.8	2.1	17%	3.4	89%
2017	0.7	1.2	71%	2.5	257%

Source: ICBC, various years (a); and author's calculations.

10b) are accounted for. Adjustments for total current-year transfers would raise the optional equity-to-claims ratio by 6 to 66 percent, depending on the year, while adjustment for the cumulative total transfers would have raised the equity-to-claims ratio by 161 percent in 2017. Instead of falling when unadjusted, the equity-to-claims ratio would have risen by 14 percent between 2009 and 2017.

Capital management: Conclusions

Transfers of capital and income have affected the capital positions of both ICBC's basic business and optional business. Without them, the MCT ratio for ICBC's basic business would have fallen below the required minimum in recent years. Unfortunately, the transfers provided little more than a band-aid and were not enough to deal with ICBC's worsening basic capital position.

While these transfers have helped the basic capital position, they have harmed the optional business. Together with transfers to the provincial government, $2.5 billion of capital has been taken out of ICBC's optional business. These transfers have left the capital position of ICBC's optional business well below the levels required for comparable private insurance providers in Canada and have threatened the sustainability of this business.

Conclusion

ICBC's finances are, as others have observed, in dire shape. The corporation's claim costs have risen, its investment income has shrunk, and its capital has fallen below the minimum mandated by the government. The cause of the deterioration in financial condition differs between its basic and its optional business.

The corporation's basic business blends the business of a commercial auto insurer and with an instrument of government policy. It is expected to be financially viable and meet the capital requirements of an insurance company at the same time as providing public services. Despite this expectation, the government has directed ICBC to limit the premiums it charges for basic coverage, to offer discounts to specific groups, and to provide a variety of additional services at its own expense while expecting it to offer insurance on a commercial basis.

ICBC's financial position on its basic business has been a victim of an unfriendly environment together with misguided provincial government policies. The unfavourable environment consists of a higher frequency and greater severity of claims that have raised its costs. Higher costs that arise from more vehicles and the resulting greater congestion are largely beyond ICBC's control. Some cost pressures, however, may be at least partly controllable. Reduced enforcement may have increased the frequency of accidents, while changes in ICBC's procedures that reduce its staff's role in assessing claims for property damage may have raised the costs of property damage.

The recent escalation of ICBC's costs is only part of the story. The mandates from the provincial government to smooth rates, together with the required income and capital transfers from its optional to its basic business and to the government itself have had unfortunate effects. Without the mandated rate smoothing, ICBC could have adjusted rates upwards to reflect the increasing costs. While customers would not have welcomed these rate increases, they would have saved ICBC from its current financial condition.

The rate smoothing mechanism has caused ICBC's basic business to suffer losses that threaten its solvency because they have prevented its premiums from covering its costs. Transfers to support the basic business

together with transfers to the provincial government have drained capital from ICBC's optional business, reducing its financial viability.

Transfers have been a band-aid and not a solution for the problems plaguing ICBC's basic business. They have masked the underlying issues and delayed the adoption of remedies. ICBC's condition is now so dire that the attorney-general has been forced to suspend the regulatory capital requirements. The task of restoring ICBC's finances requires that its substantial capital shortfall be overcome and the viability of its current insurance operations be restored.

ICBC differs from private insurers in one important respect. Private property and casualty insurers can and have failed without there being a substantial impact on the auto insurance market. Such failures disrupt the insurance market only to a minor degree because other insurers move in quickly to take over the failed insurer's business. Were ICBC to fail, it would be much more damaging because of its size—over $5.0 billion in annual premiums—and because it is the sole supplier of mandatory insurance in British Columbia.

ICBC's financial position is unsustainable. The current government deserves credit for bringing the issue forward and seeking informed advice. Band-aid solutions will not be enough: ICBC's role must be rethought, as must the objectives and role of government in the insurance business. Should ICBC be treated as a purely commercial concern or should it instead continue to serve as an instrument of government policy? If the latter, then how can these activities be sustained and managed without impairing ICBC's financial condition? These are questions we will seek to answer in subsequent research.

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Acknowledgments

The author thanks three anonymous referees and Charles Lammam for their constructive comments and Kristin McCahon for her skillful editing. Any remaining errors or oversights are the sole responsibility of the authors. As the researchers have worked independently, the views and conclusions expressed in this paper do not necessarily reflect those of the Board of Directors of the Fraser Institute, the staff, or supporters.

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Date of issue

April 2018

ISBN

978-0-88975-487-4

Citation

John Chant (2018). *The Decline and Fall of ICBC*. Fraser Institute. <http://www.fraserinstitute.org>.

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