Financial Report

Discussion of Results

Highlights

ICBC continues to face significant rate pressure due to increasing claims costs that, without the product changes introduced in 2018/19, would result in extraordinary increases to insurance rates for British Columbians. The rising cost of litigated injury claims is the single biggest cost pressure impacting the insurance rates British Columbians currently pay. ICBC is working with Government to implement changes to the Basic insurance product that focus on increased accident benefits and a limit on pain and suffering payouts for minor injury claims. These changes, along with a new independent dispute resolution process, are projected to help save approximately a billion dollars per year, while also allowing for substantially increased care for anyone who is injured in a crash. These changes are urgently needed to address rapidly rising claims costs that resulted in ICBC's ongoing financial losses and to create a sustainable auto insurance system that is more affordable and focused on injury recovery.

Net claims incurred in 2018/19 are higher than the previous year mainly due to a higher emergence of large loss bodily injury claims which run into hundreds of thousands of dollars each, as well as a continued increase in the average cost per claim and lower closure rates. In the lead up to product reform, ICBC anticipated that increased pressure from plaintiff counsel could make settling legally represented claims more challenging in 2018/19, but the observed experience of higher paid settlements and lower claims closure rates has been more severe than expected. ICBC was not able to settle as many represented bodily injury claims in 2018/19 as it did in 2017/18. This decline in closures comes despite a substantial increase in the number of such claims being handled.

ICBC continued to increase its complement of claims and claims related staff in response to the complexity of claims, and to provide support in transition to the new claims process following product reform. ICBC also updated its claims injury strategy in January 2019, ensuring consistent and fair quantification of damages.

In February 2019, Government announced amendments to the Rules of Court to address the disproportionate use of experts and expert reports in claim cases, by limiting the number of expert reports used in court cases. This change will help to reduce escalating disbursement costs for litigated injury claims, and brings British Columbia in line with other provinces that limit the number of experts in court cases.

Financial Resource Summary

The table below provides an overview of ICBC's 2018/19 financial performance relative to its *2018/19—2020/21 Service Plan*.

$ millions[1]	2017/18 Actual	2018/19 Budget	2018/19 Actual	2018/19 Variance
Premiums earned [2]	5,329	5,858	5,823	(35)
Service fees and other	113	119	125	6
Total earned revenues	**5,442**	**5,977**	**5,948**	**(29)**
Provision for claims occurring in the current year	5,084	6,038	5,308	730
Change in estimates for losses occurring in prior years [3]	563	(76)	1,221	(1,297)
Net claims incurred	**5,647**	**5,962**	**6,529**	**(567)**
Claims service and loss management [4]	402	440	419	21
Insurance operations expenses [4]	261	288	279	9
Premium taxes and commissions [4, 5]	792	456	307	149
Total expenses	**7,102**	**7,146**	**7,534**	**(388)**
Underwriting loss	**(1,660)**	**(1,169)**	**(1,586)**	**(417)**
Investment and other income	462	616	558	(58)
Income (loss) - insurance operations	**(1,198)**	**(553)**	**(1,028)**	**(475)**
Non-insurance operations expenses [4]	102	105	102	3
Non-insurance commissions [4]	31	32	31	1
Non-insurance - other income	(6)	(6)	(7)	1
Net loss	**(1,325)**	**(684)**	**(1,154)**	**(470)**
At year end:				
Long-term debt	-	-	-	
Total liabilities	16,999	18,594	19,728	
Equity:				
- Retained earnings (deficit)	1,133	479	(21)	
- Other components of equity	(161)	(59)	125	
- Non-controlling interest	15	19	15	
Total equity	**987**	**439**	**119**	
Capital Expenditures	54	105	66	
Autoplan policies earned [6]	3,833,000		3,895,000	
Average premium ($) [7]	1,364		1,441	
Claims reported during the year [8]	1,047,000		1,021,000	

[1] Financial information for all years is prepared based on International Financial Reporting Standards (IFRS).

[2] Premiums earned are net of mid-term changes and cancellation refunds.

[3] ( ) denotes a favourable adjustment, i.e., a reduction in expense.

[4] See Note 18 of the consolidated financial statements for details of Operating Expenses by Nature.

[5] Premium taxes and commissions include deferred premium acquisition cost adjustments.

[6] Annualized values have been used for policies with a term of less than 12 months. Autoplan policies earned include Basic, storage and temporary operating permit policies.

[7] Average premium is based on Autoplan premiums earned.

[8] Claims reported represent the number of claims reported against purchased insurance coverages.

Basic and Optional Comparative Summary Table

$ millions	Basic - Actual vs. Prior Year			Optional - Actual vs. Prior Year		
	2017/18 Actual[1]	2018/19 Actual	2018/19 Variance	2017/18 Actual[1]	2018/19 Actual	2018/19 Variance
Premiums earned [2]	3,149	3,390	241	2,180	2,433	253
Service fees and other	69	74	5	44	51	7
Total earned revenues	**3,218**	**3,464**	**246**	**2,224**	**2,484**	**260**
Provision for claims occurring in the current year	3,451	3,621	(170)	1,633	1,687	(54)
Change in estimates for losses occurring in prior years [3]	218	718	(500)	345	503	(158)
Net claims incurred	**3,669**	**4,339**	**(670)**	**1,978**	**2,190**	**(212)**
Claims service and loss management	274	280	(6)	128	139	(11)
Insurance operations expenses	122	120	2	139	159	(20)
Premium taxes and commissions [4]	446	(136)	582	346	443	(97)
Total expenses	**4,511**	**4,603**	**(92)**	**2,591**	**2,931**	**(340)**
Underwriting loss	**(1,293)**	**(1,139)**	**154**	**(367)**	**(447)**	**(80)**
Investment and other income	325	397	72	137	161	24
Loss - insurance operations	**(968)**	**(742)**	**226**	**(230)**	**(286)**	**(56)**
Non-insurance operations expenses	102	102	-	-	-	-
Non-insurance commissions	31	31	-	-	-	-
Non-insurance - other income	(6)	(7)	1	-	-	-
Net loss	**(1,095)**	**(868)**	**227**	**(230)**	**(286)**	**(56)**
Optional net income transfer to Basic business	99		(99)	(99)		99
Net loss after income transfer	**(996)**	**(868)**	**128**	**(329)**	**(286)**	**43**
At year end:[5]						
Liabilities:						
Unearned premiums	1,550	1,636		1,080	1,249	
Provisions for unpaid claims	8,608	10,338		3,288	3,950	
Equity:						
- Retained earnings (deficit)	933	65		200	(86)	
- Other components of equity	(112)	92		(49)	33	
- Non-controlling interest	10	10		5	5	
Total equity	**831**	**167**		**156**	**(48)**	

[1] 2017/18 Basic and Optional commission allocation was adjusted.

[2] Premiums earned are net of mid-term changes and cancellation refunds.

[3] ( ) denotes a favourable adjustment, i.e., a reduction in expense.

[4] Premium taxes and commissions include deferred premium acquisition cost adjustments.

[5] Balances presented at year end as of March 31, 2018 and March 31, 2019, respectively.

Variance and Trend Analysis

The 2018/19 net loss of $1,154 million was $171 million lower than the $1,325 million net loss in 2017/18. This was mainly due to a favourable deferred premium acquisition cost (DPAC) adjustment, higher premiums earned, and higher investment income, partially offset by higher claims costs compared to the previous period. Compared to budget, the current year's net loss was $470 million higher than the budgeted net loss of $684 million. This was largely due to higher than expected prior years' claims adjustments as the result of the continuation of higher paid severity and lower closure rates. Large bodily injury claims from prior years continue to emerge at higher rates than expected.

Premiums earned

Premiums earned in 2018/19 were $5,823 million which is an increase of $494 million compared to 2017/18. This is due to the impact of the Basic insurance rate increase of 6.4 percent effective November 1, 2017. To a lesser extent, Optional insurance rate increases and a growth in the number of insured vehicles also contributed to increased premiums earned. Premiums earned were consistent with budget.

Service fees and other

Service fees and other are primarily comprised of interest and other fees received from policyholders who have chosen to finance their insurance premiums over the policy period. Service fees are in line with premiums earned.

Claims costs

Cost of claims incurred account for more than three quarters of ICBC's total costs. They are comprised of the expected costs to settle claims for all crashes that have occurred during the fiscal period, regardless of when the crash was reported to ICBC, and the change in estimates for losses that occurred in prior periods. Claims incurred costs include payments made to settle claims, adjusters' case reserves and actuarial estimates of the additional costs that will be paid on known claims and claims not yet reported.

Claims incurred costs are affected by the growth in the number of policies, the chance of having a claim (frequency) and the average expected costs to settle those claims (severity). Frequency is influenced by factors that include driving and claimant behaviour, driver experience, weather and the effectiveness of road safety and loss management programs. Severity is influenced by factors that include legal representation, litigation, settlement awards, legal fees, medical inflation, vehicle parts/repair inflation and independent adjusting costs.

Overall, 2018/19 net claims incurred costs of $6,529 million were $882 million higher than the claims costs incurred in 2017/18 due to the worsening claims trends discussed above. This increase was driven by the increase in current period claims costs and the prior periods' claims costs adjustments.

Net claims incurred costs in 2018/19 were $567 million higher than budget, with a favourable difference of $730 million in current period claims costs and an increase of $1,297 million in prior periods' adjustments.

Current year claims costs are better than budget due to improving crash frequency. In 2018/19 there was a reduction in the number of crashes, which is an encouraging development from record high levels in 2016/17 and 2017/18. Despite the decline in crashes, the overall cost of claims has risen and continues to put upward pressure on insurance rates. ICBC will continue to monitor crash rates and invest in road safety programs that encourage safe driving behaviours (see more details on page 13, Strategy 4: Reducing injury and death on B.C. roads).

Prior years' claims adjustments are worse than budget due to a higher than anticipated number of large, severe bodily injury claims, taking longer to settle and increasing claims costs.

$ millions	2014 Actual	2015 Actual	2016/17 Actual *(15 months)*	2017/18 Actual	2018/19 Actual
Net Claims Incurred Costs	**3,560**	**4,042**	**5,966**	**5,647**	**6,529**
Injury	2,438	2,748	3,955	3,902	4,854
Material Damage and Other	1,122	1,294	2,011	1,745	1,675

Data Source: ICBC financial systems

Injury claims

Current year injury claims account for approximately 68 percent of current year claims incurred costs in 2018/19, and include bodily injury claims and accident benefit claims. Injury claims include amounts for pain and suffering, future care, past and future wage loss, medical expenses and external claims handling expenses. Overall, the total cost of current year injury claims have increased in 2018/19 compared to 2017/18. This reflects the increased severity of large bodily injury claims.

Bodily injury claims costs accounted for over 90 percent of the total current year injury claims costs. With the introduction of product reform and shifting to a care based model, more costs are incurred under accident benefits, reducing bodily injury costs.

$ millions	2014 Actual	2015 Actual	2016/17 Actual *(15 months)*	2017/18 Actual	2018/19 Actual
Current Year Injury Claims Incurred (major categories)	**2,295**	**2,563**	**3,570**	**3,334**	**3,498**
Bodily Injury	2,130	2,380	3,308	3,114	3,162
Accident & Death Benefits	165	183	262	220	336

Data Source: ICBC financial systems

Material damage (non-injury) claims

Material damage claims can largely be categorized into property damage, collision, comprehensive and windshield claims. Overall, the total cost of current year material damage claims was consistent with 2017/18. In 2018/19, ICBC began work toward modernizing the Material Damage program with a goal to contain costs in line with industry standards. The changes are also intended to incentivize suppliers to elevate their performance. Implementation of these changes is expected in 2019/20.

$ millions	2014 Actual	2015 Actual	2016/17 Actual *(15 months)*	2017/18 Actual	2018/19 Actual
Current Year Material Damage Claims Incurred (major categories)	**1,038**	**1,156**	**1,755**	**1,555**	**1,548**
Property damage	401	433	704	673	643
Collision	427	491	727	583	612
Comprehensive	150	166	222	198	195
Windshield	60	66	102	100	98

Data Source: ICBC financial systems

Change in estimates for losses occurred in prior years

Adjustments to the prior periods' claims reserves are due to the re-estimation of future payments for claims incurred in prior periods that are in progress and for those that are not yet reported. As time passes, more claims are paid and more information becomes available, enabling the estimate of the remaining future claims payments to be refined.

In 2018/19, the change in estimates for losses that occurred in prior periods was unfavourable as compared to 2017/18. This is a result of the emergence of a greater number of large bodily injury claims than expected from previous years, and an increase in the time required to resolve these claims.

Provision for unpaid claims

The provision for unpaid claims is the largest liability on the consolidated statement of financial position. It is an estimate of future claims payments relating to claims that have already occurred. The adequacy of this unpaid claims liability is reviewed and adjusted periodically throughout the fiscal year based on revised actuarial estimates, which include a provision for adverse deviations (see note 2d to the consolidated financial statements).

The provision for unpaid claims as at March 31, 2019 was $14,288 million; however, estimates for future payments can change significantly due to the time frame in which certain types of claims are settled, which can be over a number of years. The provision for unpaid bodily injury claims accounts for approximately 90 percent of total unpaid claims costs. As illustrated in the table below, only a small percentage of bodily injury claims costs are paid and known in the first year of the claim's occurrence, with a greater portion of the costs being an estimate of claims costs payable in future years.

	End of Year 1	**End of Year 2**	**End of Year 3**	**End of Year 4**	**End of Year 5**	**End of Year 6**
Breakdown of Bodily Injury Costs (%) (typical accident year)	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Paid	2%	12%	25%	40%	60%	80%
Unpaid	98%	88%	75%	60%	40%	20%

ICBC commissions the services of an external actuary to provide an independent assessment of the provision for unpaid claims and, as part of the annual audit of the financial results, the external auditor's actuary also reviews the adequacy of the unpaid claims reserves.

ICBC earns investment income on funds set aside for unpaid claims from the premiums that are collected for the related policies. Investment income is earned until the claims are ultimately paid. In accordance with accepted actuarial practice in Canada, ICBC reports the provision for unpaid claims on a discounted basis to reflect the time value of money. The discounted amount takes into account the expected timing of future payments related to unpaid claims (see note 14 to the consolidated financial statements). The discount rate is based on the expected return of ICBC's current investment portfolio. An increase in the discount rate applied to claims costs will reduce the unpaid claims balance while a decrease in the discount rate will increase the unpaid claims balance. As of March 31, 2019, the discount rate of 3.7 percent increased by 62 basis points from the prior period's discount rate of 3.1 percent, which resulted in a decrease to the balance of unpaid claims.

Road safety and loss management

In 2018/19, ICBC invested $54 million in road safety initiatives and loss management programs, which include auto crime and fraud prevention, investigation and detection to help reduce claims costs.

Using a safe systems approach, ICBC targets its road safety investments on the major risks that impact customers and costs in the business, including distractions, high-risk driving, impaired driving and vulnerable road users. Over the past year, ICBC worked with a network of partners across the province to deliver road safety programs that help protect customers from risks on the road by reducing the frequency and impact of crashes and crime.

ICBC continued to support enhanced enforcement initiatives through a funding agreement with the Ministry Public Safety and Solicitor General. In 2018/19, ICBC invested approximately $22 million in enhanced enforcement, such as CounterAttack, distracted driving, speed enforcement and seat belt checks. ICBC also invested in public education and awareness, and community initiatives to help change driver behaviours.

Operating expenses

Operating expenses include compensation and other expenses required to operate the insurance and non-insurance businesses with the exception of claims payments, commissions and premium taxes. In 2018/19, ICBC continued to manage controllable operating expenses by being an operationally excellent, low-cost organization, with a continued focus on prudent management of administration costs.

In 2018/19, claims related operating expenses of $419 million were higher than 2017/18. This is primarily due to higher compensation expenses from hiring additional claims and claims-related staff in an effort to manage claims complexity. Claims related operating expenses in 2018/19 were lower than budget due to lower salary rates and differences in staff mix in claims functions.

Included in total operating expenses are non-insurance operating expenses of $102 million, which consist of expenses for administering driver licensing, vehicle registration and licensing, and Government fines collection. Non-insurance costs are primarily funded from Basic insurance premiums.

$ millions	2017/18 Actual	2018/19 Budget	2018/19 Actual
Operating Expenses	**765**	**833**	**800**
Claims related costs	402	440	419
Insurance	261	288	279
Non-Insurance	102	105	102

Below is a table of total operating expenses by nature:

$ millions	2017/18 Actual	2018/19 Budget	2018/19 Actual
Operating Expenses by Nature	**765**	**833**	**800**
Employee benefit expense	489	530	503
Professional, administrative and other	191	217	207
Depreciation & amortization	55	55	59
Road improvements and other traffic safety programs	30	31	31

Acquisition costs

Acquisition costs represent the amounts paid to brokers and appointed agents for the sale of ICBC's insurance products and the administration of driver and vehicle licensing transactions, respectively. Acquisition costs also include premium taxes (4.4 percent of premiums) collected and paid to the Provincial Government.

Consistent with the recognition of premium revenue earned over the duration of the policy, premium acquisition costs are deferred and amortized as expense on a similar basis. When future claims and related expenses, after consideration of investment income, are expected to exceed unearned premiums, DPAC are written down and a premium deficiency liability is recognized. Conversely, where there has been a previous premium deficiency, a positive adjustment is made to eliminate the premium deficiency when unearned premiums are expected to exceed future claims and related expenses. As at March 31, 2019, the net Corporate DPAC asset was $308 million, after a positive premium deficiency adjustment of $388 million (see notes 18 and 19 to the accompanying consolidated financial statements).

Acquisition costs (including non-insurance commissions) of $338 million were lower than prior period and budget. This is mainly due to a favourable premium deficiency adjustment based on lower crash frequency and improved profitability expected in the future. Higher broker commissions and premium taxes in 2018/19 were in line with higher premiums earned.

Investments

ICBC has an investment portfolio with a carrying value of $17,150 million, which represented 86 percent of the Corporation's total assets as at March 31, 2019.

Funds available for investment purposes come primarily from the premiums collected and set aside for unpaid claims. ICBC maintains a conservative investment portfolio, with a significant allocation to high-quality fixed income securities.

As at March 31, 2019, 67 percent of the carrying value of the portfolio took the form of high-grade corporate and government bonds, money market securities and mortgage instruments, while 33 percent of the portfolio was invested in equity, real estate and infrastructure investments. The decrease in the allocation to bonds and the increase in the allocation to the other investments compared to prior year is a result of transitioning the investment portfolio to the new strategic asset mix. The new strategic asset mix decreases the allocation to bonds and increases the allocations to equities and alternative assets (e.g., infrastructure).

Investment and other income

In 2018/19, investment income was $558 million. This was higher than the investment income in the prior period, mainly due to higher dividend income and real estate gains on dispositions. These were partially offset by bond losses due to rising interest rates. Overall, these results equate to an accounting investment return of 3.4 percent in 2018/19, compared to 2.9 percent in 2017/18, based on the average investment balance during the period on a cost basis.

The investment income was $27 million higher than budget, mainly due to higher bond interest income, equity gains from trading activities and unplanned real estate dispositions. This was partially offset by larger than planned bond losses, lower than planned dividend and real estate income, and asset impairments.

The 2018/19 investment and other income budget also included gains on the sale of own-use properties of $85 million; however, these properties were not sold.

$ millions	2017/18 Actual	2018/19 Budget	2018/19 Actual
Investment and Other Income	**462**	**616**	**558**
Investment Income	**462**	**531**	**558**
Interest, dividends & other income	377	561	521
Gains (losses) on sale of investments	85	(30)	37
Other Income - gain on sale of own-use properties	**-**	**85**	**-**

Equity

ICBC's equity at March 31, 2019 was at $119 million. Equity has historically helped to absorb significant unexpected increases in claims costs and volatility in the financial markets. However, given the impact of continued worsening claims costs and several consecutive years of recurring losses, the capital base has been diminished.

As at March 31, 2019, ICBC had a net gain of $143 million in the accumulated other comprehensive income. The unrealized gains and losses included in other components of equity reflect the changes in fair value for bonds and equities and the realization of gains and losses during the year.

The adequacy of equity or capital base is an important factor in assessing the financial stability of an insurance company and is closely monitored by regulators. For federally regulated insurance companies, the common industry method used to measure financial stability is the MCT ratio, an OSFI risk-based capital adequacy framework which assesses assets, policy liabilities and other potential liabilities to determine appropriate capital levels. Although ICBC is not federally regulated, legislation and regulation require ICBC to use the OSFI MCT framework to set capital targets.

As at March 31, 2019, ICBC's corporate MCT level of -7 percent was lower than the prior year. This was primarily due to the cumulative net losses from recent fiscal years as a result of continuing pressure from claims costs and inability to set Basic insurance rates to cover costs. For further information on the Basic insurance and Optional insurance capital framework, please refer to notes 10, 21 and 23 to the accompanying consolidated financial statements.

Optional income and capital transfers to Basic

With the increasing claims costs and recent net losses, capital levels continue to decrease. The income transfer of $99 million and the capital transfer of $470 million from the Optional insurance line of business to the Basic insurance line of business on April 1, 2017 and September 15, 2017, respectively, were aimed at bolstering the Basic MCT ratio and maintaining it above the regulatory minimum of 100 percent. These transfers were not sufficient to offset the worsening claims trends. The Optional insurance line of business has also experienced a continuing pressure from rising claims costs, in particular, emergence of large and represented claims. As a result, Optional capital has been depleted and is no longer available to bolster Basic capital.

On February 26, 2018, Government issued direction to temporarily suspend the IC2 requirement to maintain Basic MCT at 100 percent for the policy years 2018 through 2021.

Basic and Optional insurance operations

ICBC operates as an integrated company providing Basic and Optional insurance products and services. Integrated operations provide benefits to ICBC's customers, such as ease of service and savings achieved through economies of scale.

The majority of premium revenues and claims costs are specifically identifiable as Basic or Optional; however, certain costs are not tracked separately. For those costs that are not specifically identified as Basic or Optional, a financial allocation methodology, as approved by the BCUC, is used to allocate costs between these two lines of business. Detailed financial information on Basic and Optional lines of business is included in note 23 to the accompanying consolidated financial statements. The following paragraphs provide a high-level summary of results for Basic and Optional lines of business, while the balance of the annual report discusses results based on integrated operations.

The Basic insurance business incurred a net loss of $868 million. The Basic net loss was better than the prior period due to a favourable DPAC adjustment, higher premiums earned, and higher investment income, which were partially offset by higher claims costs.

In 2018/19, the Optional insurance business incurred a net loss of $286 million, which was better than the net loss in 2017/18, mainly due to higher revenues from vehicle growth and Optional insurance rate increases, partially offset by higher claims.

Risks and uncertainties

ICBC has a well-established risk management process in place, using the ISO 31000 framework, to identify and evaluate the impact that significant risks could have on the achievement of corporate objectives and to identify controls in place to mitigate residual risk to acceptable levels, in order to protect ICBC against financial and reputational harm. ICBC periodically assesses its risk management processes and continues to evolve these processes in order to improve established controls. Identified risks are captured in a corporate risk register for periodic monitoring and reporting. Risks are categorized in accordance with COSO ERM[4] definitions and are aggregated for quarterly reporting to ICBC's executives and the Board of Directors.

[4] COSO (Committee of Sponsoring Organizations of the Treadway Commission) ERM (Enterprise Risk Management) is a widely accepted framework used by management to enhance an organization's ability to manage uncertainty, consider how much risk to accept, and improve understanding of opportunities as it strives to increase and preserve stakeholder value.

As a provider of vehicle insurance products, a sub-set of the risks ICBC is exposed to include industry and financial risks, which may have an impact on ICBC's financial results. Refer to note 10 to the accompanying consolidated financial statements for further details on ICBC's management of these industry and financial risks.