

MANITOBA)
)
THE PUBLIC UTILITIES BOARD ACT) Order 135/14
)
THE MANITOBA PUBLIC INSURANCE ACT)
) December 5, 2014
THE CROWN CORPORATIONS PUBLIC)
REVIEW AND ACCOUNTABILITY ACT)

Before: Régis Gosselin, B ès Arts, C.G.A., M.B.A., Chair
Karen Botting, B.A., B.Ed., M.Ed., Vice Chair, Acting Chair
The Hon. Anita Neville, P.C., B.A. (Hons.), Member
Susan Proven, P.H.Ec., Member
Allan Morin, B.A., ICD.D., Member

**MANITOBA PUBLIC INSURANCE CORPORATION (MPI):
COMPULSORY 2015/2016 DRIVER AND VEHICLE INSURANCE PREMIUMS
AND OTHER MATTERS**

TABLE OF CONTENTS

| | Page |
|---|-------------|
| EXECUTIVE SUMMARY | 4 |
| 1.0 THE RATE APPLICATION | 7 |
| 2.0 PROGRAM REVENUE | 11 |
| 2.1 Revenue Requirement | 11 |
| 2.2 Vehicle Premiums..... | 12 |
| 2.3 Driver Premiums | 12 |
| 2.4 Investment Income..... | 12 |
| 2.5 Service Fees and Other Revenues | 13 |
| 2.6 Interveners' Positions..... | 13 |
| 2.7 Board Findings..... | 15 |
| 3.0 PROGRAM COSTS | 17 |
| 3.1 Claims Incurred..... | 17 |
| 3.2 Expenses Overview | 21 |
| 3.3 Claims Expenses | 21 |
| 3.4 Operating Expenses | 21 |
| 3.5 Information Technology Expenses | 23 |
| 3.6 Benchmarking..... | 24 |
| 3.7 Recycled Parts..... | 26 |
| 3.8 Interveners' Positions..... | 28 |
| 3.9 Board Findings..... | 32 |
| 4.0 INVESTMENTS | 35 |
| 4.1 Investment Portfolio | 35 |
| 4.2 Investment Management | 36 |
| 4.3 Investment Returns..... | 37 |
| 4.4 Interest Rate Risk | 37 |
| 4.5 Investment Income Forecasting | 40 |
| 4.6 Interveners' Positions..... | 41 |
| 4.7 Board Findings..... | 42 |

| | | |
|------|---|----|
| 5.0 | RATE STABILIZATION RESERVE | 44 |
| 5.1 | <i>RSR Balance</i> | 44 |
| 5.2 | <i>RSR Target History</i> | 47 |
| 5.3 | <i>RSR Rebuilding Fee</i> | 48 |
| 5.4 | <i>Interveners' Positions</i> | 49 |
| 5.5 | <i>Board Findings</i> | 51 |
| 6.0 | RATE DESIGN..... | 56 |
| 6.1 | <i>Actuarial Methodology</i> | 56 |
| 6.2 | <i>Vehicle Classification System</i> | 56 |
| 6.3 | <i>Major Classification, Insurance Use and Rating Territory</i> | 56 |
| 6.4 | <i>Canadian Loss Experience Automobile Rating ("CLEAR")</i> | 56 |
| 6.5 | <i>Actuarial Standards of Practice</i> | 57 |
| 6.6 | <i>Interveners' Positions</i> | 57 |
| 6.7 | <i>Board Findings</i> | 58 |
| 7.0 | ROAD SAFETY | 60 |
| 7.1 | <i>Interveners' Positions</i> | 62 |
| 7.2 | <i>Board Findings</i> | 64 |
| 8.0 | PREVIOUS BOARD ORDERS | 65 |
| 9.0 | PRESENTERS | 66 |
| 10.0 | IT IS THEREFORE RECOMMENDED THAT: | 72 |
| 11.0 | IT IS THEREFORE ORDERED THAT: | 73 |

Appendices

| | | |
|---|--|--|
| A | Glossary of Acronyms and Terms..... | |
| B | Appearances | |
| C | Witnesses..... | |
| D | Interveners and Presenters | |
| E | Basic RSR/Capital Target Setting Undertaking Request (with context)..... | |

EXECUTIVE SUMMARY

The Public Utilities Board (Board or PUB) hereby orders an overall 3.4% rate increase to Basic compulsory motor vehicle premiums (Basic or Basic insurance) for the 2015/16 insurance year, effective March 1, 2015, for all major classes combined. There will be no change in permit and certificate rates, driver license premiums and vehicle premium discounts, service and transaction fees, fleet rebates or surcharges, or the discount on approved after-market and manufacturer/dealer installed anti-theft devices.

Each major vehicle class will receive the following average vehicle premium changes:

| Major Class | Percentage Change |
|--------------------|--------------------------|
| Private Passenger | + 3.7% |
| Commercial | - 1.8% |
| Public | + 6.2% |
| Motorcycle | - 5.8% |
| Trailers | + 6.1% |
| Off-road vehicles | - 14.3% |
| Total | + 3.4% |

Rates paid by individual policyholders will be determined based on their driving record, the kind of vehicle (make and model and year) that they drive, the purpose for which the vehicle is driven and the territory in which the policyholder resides. Policyholders' premiums will also be impacted by actual claims experience. As a result, some individuals will experience increases in insurance rates, and others will experience decreases.

| \$ Change | # of Vehicles | % of Vehicles |
|-----------------------------------|----------------------|----------------------|
| Decrease of \$300 or more | 9 | 0.00% |
| Decrease of \$200 to \$299 | 217 | 0.02% |
| Decrease of \$150 to \$199 | 609 | 0.06% |
| Decrease of \$100 to \$149 | 3,327 | 0.31% |
| Decrease of \$50 to \$99 | 37,038 | 3.45% |
| Decrease of \$20 to \$49 | 86,798 | 8.08% |
| Decrease of \$1 to \$19 | 155,693 | 14.50% |
| No change | 123,966 | 11.55% |

| | | |
|-----------------------------------|-----------|--------|
| Increase of \$1 to \$19 | 147,171 | 13.71% |
| Increase of \$20 to \$49 | 207,056 | 19.28% |
| Increase of \$50 to \$99 | 273,037 | 25.43% |
| Increase of \$100 to \$149 | 36,468 | 3.40% |
| Increase of \$150 to \$199 | 895 | 0.08% |
| Increase of \$200 to \$299 | 699 | 0.07% |
| Increase of \$300 or more | 698* | 0.07% |
| GRAND TOTAL | 1,073,681 | 100% |

This is the third rate increase in 15 years, a period during which there were five rate decreases. A history of the percentage rate changes applied for by Manitoba Public Insurance (MPI or the Corporation) and ordered by the Board is as follows:

| Year | Applied For | Ordered |
|-------------|--------------------|----------------|
| 2015 | 3.4 | 3.4 |
| 2014 | 1.8 | 0.9 |
| 2013 | 0.0 | 0.0 |
| 2012 | -6.8 | -8.0 |
| 2011 | -4.0 | -4.0 |
| 2010 | 0.0 | 0.0 |
| 2009 | -1.0 | -1.0 |
| 2008 | 0.0 | 0.0 |
| 2007 | -2.6 | -2.6 |
| 2006 | 0.0 | 0.0 |
| 2005 | 0.0 | -1.0 |
| 2004 | 2.5 | 3.7 |
| 2003 | 0.0 | 0.0 |
| 2002 | -1.2 | 0.0 |
| 2001 | 0.0 | 0.0 |

There have also been \$597 million in premium rebates ordered by the Board over the last 15 years.

The rate increase is needed to improve the financial results of Basic insurance, which has sustained combined losses for 2012/13 and 2013/14 of \$132.2 million. MPI is also projecting a net loss of \$82.5 million for the current financial year. These losses have been caused by higher claims costs due to last year's severe winter, a drop in interest rates, an increase in collision and comprehensive severity costs, the increase in the provincial sales taxes and higher negotiated repair shop labour rates.

Basic insurance revenues need to increase because of cost increases due to inflation and higher collision costs due to changes in manufacturer vehicle design in the order of \$30 million per year in the outlook period. In addition, MPI has projected increases in the ultimate Personal Injury Protection Plan (PIPP) forecast due to significant PIPP reserve increases in 2013/14 resulting from a comprehensive review of existing claims.

The past losses and the loss forecasted for this financial year will decrease the Rate Stabilization Reserve (RSR) balance to \$17.4 million, well below the Board's previously approved target range of \$82.3 million to \$164.3 million. The RSR is intended to maintain rate stability. Too low a reserve means that a few unexpected events, such as a severe hail storm and winter storm, could trigger losses that would require a very significant rate increase.

MPI originally requested an overall 2.4% rate increase plus a 1% RSR rebuilding fee. MPI has now decided to transfer over \$100 million in excess retained earnings from its other lines of business into the rate stabilization reserve. If MPI generates excess revenues from its Basic insurance in the future, these will also increase the RSR.

On a preliminary basis, the Board accepts the proposed method for determining the appropriate RSR. Further work is required to set the specific range for the RSR which is based on the risks to which MPI is exposed; the Board directs MPI to collaborate with the PUB advisors in completing this work.

The Board continues to examine MPI's actual and projected costs to determine whether they are necessary and prudent. The Board is encouraged by the fact that MPI has made more of an effort to contain costs, and has established specific cost containment strategies. In addition, MPI has undertaken a number of projects to reduce and benchmark costs; MPI is ordered to provide updates next year.

MPI is unduly exposed to significant interest rate risk from falling interest rates; a drop in interest rates negatively impacts its financial results. Steps must be taken to mitigate this risk.

MPI is ordered to develop its loss prevention framework, though the road safety budget must be kept separate from the Corporation's budget for loss prevention activities. At the next GRA, MPI must provide an independent review of its road safety portfolio to optimize its cost of road safety and effectiveness, setting goals for outcomes and minimizing the social and economic costs of collisions.

A number of studies have been ordered by the Board to be completed by MPI in this and past Orders. The Board expects MPI to submit them as part of its next application because they will allow the Board to determine just and reasonable rates and whether MPI's expenses have been prudently incurred.

This Order reflects the Board's findings on matters which arose over the course of the proceeding through oral testimony and documentary evidence. Public access to the full transcripts of the hearing, including cross-examination, presentations and closing statements, are available on the Board's website (www.pub.gov.mb.ca).

Documentary evidence filed on the record at the hearing may be viewed at the Board's offices, and previous Board Orders may be accessed on the Board's website (www.pub.gov.mb.ca). Interested parties may also review MPI's Annual Report and quarterly financial statements on MPI's website (www.mpi.mb.ca).

1.0 THE RATE APPLICATION

The Corporation filed the 2015/16 General Rate Application (GRA or Application) with the Board on June 16, 2014 for approval of premiums to be charged with respect to Basic for the fiscal year commencing March 1, 2015 and ending February 29, 2016 (Fiscal 2015). The Application was filed in accordance with the provisions of *The Crown Corporations Public Review and Accountability Act* and *The Public Utilities Board Act*.

The original Application filed by the Corporation was for a 2.4% rate increase in written vehicle revenue and a 1.0% RSR rebuilding fee. The increased premiums would take effect on March 1, 2015.

MPI advised that a higher physical damage claims forecast and higher PIPP, operating and claims expense forecasts combined with deficient 2014/15 rates were the primary factors necessitating a rate increase. MPI advised that a 1.0% overall rate change represents approximately \$8 million in additional premium revenue for Basic per year.

In the course of the GRA hearing, based upon an October 2014 interest rate forecast, MPI put forward as an alternative position a request that the Board consider ordering an overall 3.4% or higher rate increase, with no RSR rebuilding fee.

The vehicle premium rates put forward by MPI included experience based rate adjustments largely ranging from -15% to +15%, and based on adjustment rules. In addition, the Corporation combined classification offsets for all vehicles except off-road vehicles, to achieve revenue neutrality and implemented rate group, rate line and classification changes for 2015.

Pursuant to the Corporation's alternative rate request (3.4% overall rate increase), each major vehicle class would receive the following average vehicle premium changes:

| Major Class | Percentage Change |
|--------------------|--------------------------|
| Private Passenger | + 3.7% |
| Commercial | - 1.8% |
| Public | + 6.2% |
| Motorcycle | - 5.8% |
| Trailers | + 6.1% |
| Off-road vehicles | - 14.3% |
| Total | + 3.4% |

According to the Corporation's rate design, an overall rate increase does not translate into static rate increases for all motorists within each major vehicle class.

Rather, the overall 3.4% rate increase requested by the Corporation would result in a rate decrease for 26.42% of vehicles, no change in rates for 11.6% of vehicles, and a rate increase for 62.04% of vehicles. Details of the dollar change impact by number of vehicles within the overall fleet are as follows:

| \$ Change | # of Vehicles | % of Vehicles |
|-----------------------------------|----------------------|----------------------|
| Decrease of \$300 or more | 9 | 0.00% |
| Decrease of \$200 to \$299 | 217 | 0.02% |
| Decrease of \$150 to \$199 | 609 | 0.06% |
| Decrease of \$100 to \$149 | 3,327 | 0.31% |
| Decrease of \$50 to \$99 | 37,038 | 3.45% |
| Decrease of \$20 to \$49 | 86,798 | 8.08% |
| Decrease of \$1 to \$19 | 155,693 | 14.50% |
| No change | 123,966 | 11.55% |
| Increase of \$1 to \$19 | 147,171 | 13.71% |
| Increase of \$20 to \$49 | 207,056 | 19.28% |
| Increase of \$50 to \$99 | 273,037 | 25.43% |
| Increase of \$100 to \$149 | 36,468 | 3.40% |
| Increase of \$150 to \$199 | 895 | 0.08% |
| Increase of \$200 to \$299 | 699 | 0.07% |
| Increase of \$300 or more | 698* | 0.07% |
| GRAND TOTAL | 1,073,681 | 100% |

*all Taxis except one motorcycle

The Corporation sought no change to permit and certificate rates, vehicle premium discounts and driver license premiums, service and transaction fees, fleet rebates or surcharges, or the \$40.00 discount on approved aftermarket and manufacturer/dealer installed anti-theft devices.

The Application represents the third requested rate increase in 15 years, and there have been rate decreases ordered by the Board over the last 15 years also. A history of the percentage rate changes applied for by MPI and ordered by the Board is as follows:

| Year | Applied For | Ordered |
|-------------|--------------------|----------------|
| 2015 | 3.4 | 3.4 |
| 2014 | 1.8 | 0.9 |
| 2013 | 0.0 | 0.0 |
| 2012 | -6.8 | -8.0 |
| 2011 | -4.0 | -4.0 |
| 2010 | 0.0 | 0.0 |
| 2009 | -1.0 | -1.0 |
| 2008 | 0.0 | 0.0 |
| 2007 | -2.6 | -2.6 |
| 2006 | 0.0 | 0.0 |
| 2005 | 0.0 | -1.0 |
| 2004 | 2.5 | 3.7 |
| 2003 | 0.0 | 0.0 |
| 2002 | -1.2 | 0.0 |
| 2001 | 0.0 | 0.0 |

There have also been \$597 million in premium rebates ordered by the Board over the last 15 years, as follows:

| Year | Total (\$ millions) | Percent of Premiums |
|-------------|----------------------------|----------------------------|
| 2011 | \$336 million | 45.0 |
| 2008 | \$63 million | 10.0 |
| 2007 | \$60 million | 10.0 |
| 2006 | \$58 million | 10.0 |
| 2001 | \$80 million | 16.6 |

2.0 PROGRAM REVENUE

2.1 Revenue Requirement

The Corporation derives revenue from four main sources to fund Basic: vehicle premiums, driver premiums, service and transaction fees and investment income. The Corporation's projected operating results for 2015/16, on the basis of each of the applied for 2.4% rate increase, with 1.0% RSR rebuilding fee and an overall 3.4% rate increase scenario, reflecting an updated October 2014 interest rate forecast, are as follows:

| | 2015 Applied for Rate 2.4% rate increase with 1% RSR Rebuilding Fee (\$ millions) | Alternate Scenario 3.4% rate increase no RSR Rebuilding Fee October 2014 interest rate forecast (\$ millions) |
|----------------------------------|--|--|
| Motor Vehicle Premiums | \$824.7 | \$829.2 |
| RSR Rebuilding Fee | 4.5 | --- |
| Drivers' License Premiums | 49.1 | 49.1 |
| Reinsurance ceded | (13.9) | (13.9) |
| Total Net Premiums Earned | 864.4 | 864.4 |
| Investment Income | 49.9 | 23.7 |
| Service Fees & Other Revenues | 21.0 | 21.0 |
| Total Earned Revenues | \$935.4 | \$909.1 |
| Claims Incurred | 672.1 | 636.9 |
| Claims Expenses | 120.5 | 120.8 |
| Road Safety Expenses | 10.5 | 10.5 |
| Operating Expenses | 74.8 | 75.0 |
| Commissions | 34.2 | 34.1 |
| Premium Taxes | 26.4 | 26.3 |
| Regulatory/Appeal expenses | 3.3 | 3.3 |
| Total Claims and Expenses | \$941.7 | \$907.0 |
| Net income (loss) – Basic | (\$6.3) | \$2.1 |

2.2 Vehicle Premiums

MPI originally applied for a 2.4% increase in vehicle premiums and a 1% RSR rebuilding fee. Based on this request, vehicle premiums earned are forecast to be \$829.2 million for 2015/16, inclusive of \$4.5 million representing the contribution in the year of the proposed 1% RSR rebuilding fee. The revenue earned by Basic in respect of vehicle premiums changes due to 3 factors: rate changes as ordered by the Board, growth in the number of vehicles in the fleet (the Volume Factor), and changes in the average premium per vehicle caused by factors other than rate changes, such as the gradual upgrade of the fleet as older vehicles are replaced with newer ones (the Upgrade Factor).

The combined growth of Volume Factor and Upgrade Factor is projected to be 4.35% for each of 2014/15, 2015/16 and beyond (1.75% Volume Factor and 2.6% Upgrade Factor).

2.3 Driver Premiums

When obtaining a driver's license, motorists are assessed a premium based on the principle that all drivers should contribute premiums to the insurance fund, regardless of whether they own or insure a vehicle. The level of Driver Premiums paid by licensed drivers are set based on the Drivers Safety Rating (DSR) scale which ranges from \$15 (level 15) to \$2,500 (demerit level 20).

Driver Premiums are forecast to be \$44.3 million in 2014/15 and to increase to \$49.1 million in 2015/16, an increase of approximately \$4.8 million. The forecast considers four components, including the number of earned driver units by DSR level, the expected movement of drivers on the DSR scale, the average number of earned units per driver by DSR level and the driver premiums by DSR level.

2.4 Investment Income

The Corporation's funds available for investment are primarily the assets supporting the unearned premium reserves and unpaid claims reserves. The funds within the portfolio support both the payment of accident claims as well as the pension obligations of the Corporation. As at February 28, 2014, the Corporation had short and long-term investments, including cash and equities totalling \$2.4 billion, which is forecast to remain at about that level to the end of 2015/16.

Investment income earned from the Corporation's investment portfolio reduces the revenue that is required to be collected through premiums. The Corporation's investment income is allocated between Basic, Extension and Special Risk Extension (SRE) lines of business based on the net average weighted equity balances, with approximately 83.8% of the investment income forecast to be allocated to Basic in 2015/16.

Basic realized investment income of \$147.7 million in 2013/14 and MPI has projected investment income to Basic to fall to \$74.4 million for 2014/15 and \$23.7 million for 2015/16. These projections are based on an overall 3.4% rate increase scenario reflecting the October 2014 interest rate forecast update. Further discussion on MPI's investment portfolio is found in Section 4.0 of this Order.

2.5 Service Fees and Other Revenues

Basic earned \$20.4 million in service fees and other revenues in 2013/14, and the Corporation projects that Basic will earn service fees and other revenue of \$19.8 million in 2014/15 and \$21.1 million in 2015/16. This revenue is derived mainly from quarterly and monthly pre-authorized payment plans, late payment fees, motor vehicle transaction fees, dishonoured payment fees and pre-authorized payment default fees.

2.6 Interveners' Positions

CAC

CAC noted the just and reasonable rate criteria set out by the Board in Order 98/14, and expressed the view that neither a 2.4% rate increase plus a 1.0% RSR rebuilding fee nor an overall 3.4% or 3.6% rate increase are reasonable or necessary. In support of that position, CAC cited:

- the Corporation's long-term spending issue, including dramatic growth in IT spending from 2009/10;
- stresses associated with the Bodily Injury Improvement Initiative (BI³ Project) implemented in September 2010, including claims processing lag and management of duration exposure, such that the BI³ Project is not yet achieving its promise and that there is doubt in the credibility of some of the ultimate case reserves for PIPP;
- the Corporation's failure to listen to the advice of the Board on benchmarking and cost controls; and
- a lack of comfort with the Corporation's investment income forecast.

CAC stated also that there has been a lack of clarity as to the factors driving Basic's negative financial results in the last two fiscal years, which may include some or all of:

- a bad winter in 2013/14;
- materially increasing operating costs, particularly relative to IT;
- risk taking related to the asset/liability mismatch;
- challenges in managing Personal Injury Protection Plan (PIPP) claims duration;
- actuarial reserving issues and reserving lags;
- disruption due to computer implementation issues;
- short or long term trends in collision severity;
- failure to manage collision cost estimates;
- investment income uncertainty; and
- missed opportunities in road safety investments.

CAC submitted that a rate increase of approximately 2.75% is justified and that no RSR rebuilding fee be granted. CAC stated that the rate increase should be more than what MPI applied for initially (2.4%), but less than MPI requested overall (3.4%), given concerns that the Corporation is neither minimizing its risks regarding interest rates nor managing its costs.

CMMG

CMMG stated that the average required rate for the motorcycle class should never have risen to \$1,100, and that historically, motorcyclists have been the victims of excessive rate hikes due to the inappropriate selection of a tail factor by MPI which increased its case reserves by well over \$250 million. CMMG stated that MPI's rate-making methodology does not work for a small vehicle population like the motorcycle class, with the result that motorcyclists are discriminated against, and treated inequitably and unfairly by the Corporation. Conversely, private passenger vehicle owners are treated more carefully by MPI in terms of the size of rate increases that they will accept.

CMMG noted that the motorcycle class has experienced average rate increases as large as 19% dating back to 2004 and 2005, followed by rate decreases in the last number of years. CMMG suggested that the Board apply the concept of directionality and conclude that rate decreases for the motorcycle class will continue, such that a rate decrease of 10% should be implemented for 2015/16.

2.7 Board Findings

The Board hereby orders an overall 3.4% rate increase in compulsory motor vehicle premiums for the 2015/16 insurance year, effective March 1, 2015, for all major classes combined. The Board has accepted this alternative proposal put forward by MPI, in lieu of its initial request for an overall 2.4% rate increase plus a 1% RSR rebuilding fee. The Board approves MPI's request that there be no change in permit and certificate rates, driver license premiums and vehicle premium discounts, service and transaction fees, fleet rebates or surcharges, or the discount on approved after-market and manufacturer/dealer installed anti-theft devices. The Board is satisfied that an overall 3.4% rate increase for Basic is reflective of the revenue requirement for Basic to break even in 2015/16.

The Board notes that the rates paid by individual policyholders will be determined based on their driving record, the kind of vehicle (make and model and year) that they drive, the purpose for which the vehicle is driven and the territory in which the policyholder resides. Policyholders' premiums will also be impacted by actual claims experience associated with rating factors. As a result, some individuals will experience increases in insurance rates, and others will experience decreases.

The Board does not approve CMMG's request that rates for the motorcycle class be reduced by 10% instead of 5.8% as indicated pursuant to the overall 3.4% rate increase. The Board does not accept that the treatment of the motorcycle class in the derivation of the actuarial indications in MPI's ratemaking was either unjust or unfair.

The Board's decision to increase overall rates by 3.4% is driven by:

- Basic's actual financial results in each of 2012/13 and 2013/14; net losses of \$63.1 million and \$69.1 million respectively which weakened the financial strength of Basic and reduced the RSR balance to \$99.9 million as at February 28, 2014;
- Basic's forecast financial results for 2014/15; a net loss of \$38 million as at the filing of the Application, revised to a net loss of \$82.5 million as at October 22, 2014, based on an overall 3.4% rate increase scenario and reflecting the October 2014 interest rate forecast. MPI has stated that this change resulting from the updated interest rate forecast would give rise to a 3.6% break even rate requirement for 2015/16;
- The updated forecast RSR balance for the close of the 2014/15 fiscal year, of \$17.4 million, which is well below the Board's previously approved RSR range of \$82.3 million to \$164.3 million;
- The need to rebuild the RSR to a level adequate to address the risks faced by the Corporation; and
- MPI's advice that it will transfer over \$100 million in excess retained earnings from the Extension and SRE lines of business into the RSR, to assist with rebuilding the RSR, and mitigating the need for an RSR dedicated rebuilding fee at this time.

Future Basic insurance revenues need to increase because of cost increases due to inflation and higher collision costs due to changes in manufacturer vehicle design in the order of \$30 million per year in the outlook period. In addition, MPI has projected increases in the ultimate PIPP forecast due to significant PIPP reserve increases in 2013/14 resulting from a comprehensive review of existing claims.

The Corporation advised the Board that if interest rates do not increase from the October 2014 level, Basic is expected to suffer a net loss of \$103.3 million in 2014/15, which would cause a deficit in the RSR of -\$3.4 million as at February 28, 2015. This scenario would give rise to an indicated 8.6% break-even rate requirement for 2015/16. If interest rates increase prior to the close of 2014/15, MPI's financial position will improve. Certainly, at present the Corporation's net financial results are sensitive to relatively minor changes in interest rates, discussed further in Sections 4.4 and 4.5 below.

3.0 PROGRAM COSTS

The costs associated with providing Basic Insurance to Manitoba motorists fall into the following seven major categories:

| | Total Estimated Expense 2015/16 (\$ millions) | Percentage of Total Program Costs |
|---|--|--|
| Net Claims Incurred | \$672.1 | 71.4% |
| Claims Expenses | 120.5 | 12.8 |
| Road Safety/Loss Prevention | 10.5 | 1.1 |
| Operating Expenses | 74.8 | 7.9 |
| Commissions | 34.2 | 3.6 |
| Premium Taxes | 26.4 | 2.8 |
| Regulatory/Appeal expenses ¹ | 3.3 | 0.4 |
| Total Program Costs | \$941.8 | 100.0% |

3.1 *Claims Incurred*

Claims Incurred represent the costs that are paid or forecast to be paid to claimants for the various benefits provided under the Basic Insurance program. Net claims incurred were \$100.2 million or 15.5% over budget in 2013/14. The Corporation cites the following as the key reasons for this significant difference:

- Adverse winter driving conditions which resulted in approximately 3.0% more collision and property damages claims than expected (\$16 million negative impact);
- Physical damage claims severity increase of 10% mainly due to new labour and material agreements with body shops, the 1% PST increase and higher total loss settlement values (\$24 million negative impact);
- Comprehensive review of existing injury claims that increased loss reserves for prior years' claims (\$26 million negative impact);
- Increase in internal loss adjustment expense provision (\$9 million negative impact);
- Premium deficiency for Basic due to higher than expected claims costs and continued low interest rates (\$25 million negative impact);
- Capital losses on marketable bonds due to higher interest rates (\$22 million negative impact); and
- A combination of changes from other cost categories, offset by higher than expected gains on the sale of equities account for the remaining differences.

¹ Regulatory and appeal expenses relate to: Public Utilities Board, Crown Corporations Council and Automobile Injury Claims Appeal Commission.

The Application reflects that Claims Incurred are forecast to be \$672.1 million in 2015/16 and are projected to be \$725.3 million in 2016/17, an increase of \$53.2 million. These forecasts represent an average \$35.2 million increase in Claims Incurred for each of 2015/16 and 2016/17 from last year's forecasts. The key reasons for these increases are:

- An expected increase in each of collision and comprehensive claims based on an apparent change in historical trends, of \$52.8 million;
- Adjustments to PIPP reserves due to a revised interest rate forecast, of \$11.6 million (net);
- An increase in unallocated lost adjustment expenses of \$5.3 million due to higher costs and a revised interest rate forecast; and
- A combination of changes from the other coverage and claim provision categories.

Claims Incurred by major coverages for the fiscal years 2012 - 2016 are as follows:

| For years ending February 28/29 (\$ millions) | 2012 | 2013 | 2014 | Projection 2015 | Outlook 2016 | 4 Year Change | |
|--|----------------|--------------|--------------|------------------------|---------------------|----------------------|------------|
| Physical Damage - All Perils | | | | | | | |
| Collision | 280.7 | 318.6 | 374.1 | 350.7 | 377.3 | \$96.6 | 34% |
| Comprehensive | 69.6 | 74.8 | 77.6 | 79.2 | 82.3 | 12.7 | 18% |
| Property damage | 37.7 | 42.4 | 48.2 | 40.8 | 43.2 | 5.5 | 15% |
| Sub-total | \$388.0 | 435.8 | 499.9 | 470.7 | 502.8 | 114.8 | 30% |
| PIPP Accident Benefits | 222.0 | 225.0 | 244.6 | 150.6 | 165.6 | (56.4) | (25%) |
| Public Liability | 2.0 | 0.5 | 2.9 | 3.5 | 3.7 | 1.7 | 85% |
| Total Claims Incurred | \$612.0 | 661.3 | 747.4 | 624.8 | 672.1 | 60.1 | 10% |

Collision claims costs, which represent the costs of physical damage to motor vehicles in collisions, are projected to be \$377.3 million in 2015/16, an increase of \$96.6 million or 34% from 2011/12. The Corporation stated that it has experienced higher than normal claims frequency (based on historical averages) in three of the past four years, caused mainly from poor winter driving conditions. The Corporation does not believe that this recent experience is reflective of long-term best estimate assumptions. The Corporation stated also that there were several factors that led to severity increases, the most significant of which was higher repair costs.

Comprehensive claims costs, which represent the costs of physical damage to motor vehicles occasioned by fire, vandalism, theft and severe weather, are forecast to be \$82.3 million in 2015/16, an increase of \$12.7 million or 18% from 2011/12.

MPI has advised the Board that there are significant changes in vehicle manufacturing ongoing and upcoming, as auto manufacturers are required to meet higher fuel emissions standards in North America. New makes and models with significantly higher fuel efficiency have been entering the market in the last few years and more are expected. These new vehicles include a larger portion of complex materials and technologies which will require new tooling, equipment, methods and facilities to repair properly. These changes will dramatically affect the repair industry, including the capital and operating costs of repair shops, which will in turn impact MPI's claims costs. In particular, more vehicles will be manufactured with aluminum components, including aluminum frames, which can be repaired only in a segregated repair shop environment, to avoid potential cross-contamination. MPI is anticipating that once vehicles containing aluminum frames and more expensive electronic components have entered the fleet in a significant way, it will incur additional claims costs of \$30 million per year.

Accident Benefits are payable to claimants regardless of fault for a collision, including Medical Expenses, Rehabilitation Expenses, Funeral Expense Reimbursement, Death Payments, Impairment Benefits, Income Replacement Indemnity and Personal Care Assistance expenses. The estimated cost of Accident Benefits under the PIPP program are updated based upon actuarial reserving practices taking into account changes in interest rates on long term claims liabilities.

The following table compares actual PIPP Accident Benefit costs with those previously forecast by the Corporation:

| Year Ended February 28/29 | Original Forecast | Revised Forecast | Actual Cost | Difference Original/ Actual |
|--------------------------------------|------------------------------|-----------------------------|------------------------|--|
| 2007 | \$221.2 | \$226.2 | \$184.6 | \$36.6 |
| 2008 | \$237.3 | \$231.3 | \$167.2 | \$70.1 |
| 2009 | \$242.1 | \$239.3 | \$186.1 | \$56.0 |
| 2010 | \$249.8 | \$236.2 | \$175.0 | \$74.8 |
| 2011 | \$252.9 | \$244.6 | (\$59.7) | (\$312.6) |
| 2012 | \$253.3 | \$197.3 | \$222.8 | (\$30.5) |
| 2013 | \$203.5 | \$204.2 | \$224.2 | (\$20.7) |
| 2014 | \$210.9 | \$208.5 | \$243.9 | (\$33.0) |
| 2015 | \$184.4 | \$148.9 | | |
| 2016 | \$166.1 | | | |

Current fiscal period Claims Incurred are affected by current year's claims activity as well as prior years' claims activity. When a claim is first incurred, claims adjusters make an estimate of the ultimate cost of that claim. Over time, as more is learned about the nature of the underlying injury, and as partial claim payments are made, adjustments are made to that prior estimate of ultimate cost of the claim. These adjustments, sometimes called runoff, flow through Claims Incurred in the fiscal year in which the adjustments are made.

During 2013/14, Basic's net Claims Incurred were increased by about \$26 million of net undiscounted unfavourable runoff, pursuant to a detailed case reserve review conducted by MPI. Previously, there was a pattern of favourable runoff experienced for several years. In particular, during the five fiscal year period from 2007/08 through 2011/12, MPI's Basic financial position benefited from about \$625.5 million of cumulative total net undiscounted favourable runoff. Most notably, during 2010/11, Basic's Net Claims Incurred benefited from about \$286.1 million of total net undiscounted favourable runoff. To the extent that historical experience forms the foundation for forecasting, the increase in Basic net Claims Incurred in 2013/14 gives rise to increased forecasted Claims Incurred.

3.2 Expenses Overview

The Corporation categorizes its operating expenses into three groups: Normal Operations Expenses, Improvement Initiative Implementation Expenses, and Improvement Initiative Ongoing Expenses.

Normal Operations Expenses are incurred to manage the day-to-day operations of the Corporation. Improvement Initiative Implementation Expenses represent one-time expenses to implement IT projects, examples of which include software and hardware purchases and external labour. Improvement Initiative Ongoing Expenses are the expenses that occur as a result of an IT project that continue after the project has been put into service. Examples include licensing costs for purchased software, future maintenance on hardware purchases and amortization related to deferred development.

All three types of operating expenses incurred by the Corporation are allocated to Basic pursuant to a cost allocation methodology approved by the Board previously, and are assigned to four expense categories: Claims, Road Safety/Loss Prevention, Operating and Regulatory/Appeal.

3.3 Claims Expenses

Claims Expenses represent the administrative costs associated with processing and settling claims, and account for approximately 13% of Basic program costs. Claims expenses have grown from \$84 million in 2009/10 to \$114.6 million in 2013/14, an increase of \$30.6 million or 36% over the last five years. The Corporation is forecasting Claims Expenses to be \$116.3 million in 2014/15 and \$120.5 million in 2015/16 and to grow to \$138.3 million in 2018/19, a five year increase of 21%. The main drivers of these increases are the Corporation's Compensation expenses including salaries, overtime, benefits and health & education tax as well as forecast costs related to the PDR project, which is expected to be in service in 2017/18.

3.4 Operating Expenses

Operating expenses allocated to Basic have grown significantly over time; from \$45.9 million in 2009/10, to \$68.0 million in 2013/14, an increase of \$22 million or 48% in the last five years. Operating Expenses are forecast to be \$73.6 million in 2014/15 and are projected to be \$74.8 million in 2015/16 and \$87.3 million in 2018/19. The Corporation has stated that these increases in operating expenses are attributable mainly to higher data processing costs and increased compensation costs.

From 2009/10 to 2013/14, the average salary paid by the Corporation increased from \$50,900 to \$58,987, representing a compounded annual growth rate of 3.76%, well in excess of inflation for the same period, which was 1.87%. By 2018/19, the average salary paid by the Corporation is forecast to increase to \$69,656, representing a compounded annual growth rate of 3.38% (from 2014 to 2019), compared to expected inflation of 2% for the same period. When overtime and benefits are included, compensation grew by a compounded annual growth rate of 4.5% between 2009/10 and 2013/14 and is forecast to grow at 3.7% per year through 2018/19.

The Corporation has stated that these compensation increases in excess of inflation are due primarily to the terms of the collective agreement as between MPI and the Manitoba Government and General Employees' Union, (MGEU), with which MPI negotiated a 4 year collective agreement, effective from September 2012 to September 2016. Pursuant to the collective agreement, staff received no wage increase during the first two years, but will receive a 2.75% wage increase in each of the last two years of the agreement, such that in 2015/16, the Corporation will bear the full impact of the 2.75% increase. In addition, the collective agreement provides for five annual increases of 3.5% for each in-scope position, up to a maximum salary per position. MPI estimates that 50% of its employees are eligible for these annual increases, which is the equivalent of a 1.75% annual wage increase. As a result of these two contractual requirements, MPI is forecasting annual increases in compensation of 4.5% for each of 2014/15 and 2015/16.

MPI's Normal Operations staffing levels increased from 1,732 Full-Time Equivalent (FTE) in 2008/09 to 1,890.3 FTE in 2013/14 and are projected to grow to 1,927.7 FTE in 2014/15. The Corporation has stated that it has implemented a hiring freeze for an indeterminate period of time, which applies to approximately 40% of its employees (non front-line staff). MPI also stated that it has eliminated 7 FTE positions in 2014/15 with a forecast savings of \$400,000.

The Corporation has stated that at a given time, there are vacant positions within its staff complement, referred to as a vacancy provision which reduces salary expenses. The Corporation set the vacancy provision at 75 FTEs for 2014/15 and plans to increase the vacancy provision in the next three years to 110 - 120 FTEs, with a targeted incremental staff reduction of 30 FTEs and \$6.2 million in savings in 2015/16.

In addition, MPI has restricted all out-of-province travel and conference participation for its staff, for an indeterminate period of time, that it has restricted internal staff meeting costs and that it has formed a committee of senior managers to identify, investigate and implement operating cost reduction initiatives and further cut discretionary spending. MPI has realized \$109,000 in savings in the first six months of 2014/15 and anticipates that those savings may double for the year. MPI stated that it has shown fiscal prudence in managing its operating costs and that convenience and service for its customers are its priority.

3.5 Information Technology Expenses

MPI has pursued IT projects targeted towards modernizing its IT footprint, including the following initiatives: Data Centre Optimization, IT Optimization, Driving Ahead in Real Time (DART), Information Security Strategy, Broker Refresh, Physical Damage Re-engineering, Human Resource Management as well as other initiatives.

MPI's total Corporate IT expenses, including operating expenses and capital investments, have increased from \$31.3 million in 2005/06 to \$87.2 million in 2013/14, with a compounded annual growth rate of 13.7 % and are forecast to increase to \$96.4 million in 2018/19. In 2013/14, approximately 42% of the Corporation's spending was directed to strategic IT initiatives. MPI has engaged approximately 120 to 140 external consultants to assist in delivering on its IT initiatives at a cost of approximately \$30 million per year.

MPI's major capital IT initiative is the Physical Damage Re-engineering Project (PDR Project). The strategy of the PDR Project is to employ a distributed enterprise model whereby MPI embeds technology into repair facilities to work collaboratively with its partners in streamlining collision repair processes to realize claims cost savings. MPI estimates that the PDR Project will cost approximately \$65 million to implement, and will be put into service by 2017/18. MPI expects that it will realize \$13 million in annual savings as a result of the PDR Project which will be offset by \$5 million in additional software licensing and other costs for a net annual savings of \$8 million when the initiative is put into service. At last year's GRA, MPI advised that the final cost of its Human Resource Management System was \$16 million; 60% higher than the \$10 million budget provided previously. In Order 151/13, the Board stated that it was very concerned about cost overruns, and that MPI had not demonstrated the benefits of its IT investments, including financial payback. The Board ordered MPI to file, at this year's GRA, a five-year IT strategic plan, including a cost-benefit analysis, justifying its current and future IT expenditures.

3.6 Benchmarking

In Order 151/13, the Board ordered that MPI file at this GRA:

- staffing and cost control results;
- a five-year IT strategic plan, including a cost-benefit analysis, justifying its current and future IT expenditures; and
- a benchmarking framework, along with benchmarking indicators to which the Corporation intends to be held accountable.

MPI has acknowledged the importance of benchmarking, to identify improvement opportunities for managing expenses and the efficiencies of its operations to move forward successfully. The Corporation filed with the Board a benchmarking framework reflecting four subject areas: Operational Efficiency, IT Service Delivery, Serving Manitobans and Community Impact.

In addition, MPI filed with the Board an Operational Efficiency document reflecting information obtained by the Corporation from the Ward Group, including a comparison of the Corporation to other auto insurers.

The Ward Group comparison shows that the Corporation's total gross expenses as a percentage of gross premiums written and per policy in force are below the comparators, including the Canadian Auto Group (includes 2 public insurers), the Canadian Benchmark Group (includes 2 public insurers) and the U.S. Personal Auto Group. The Corporation's FTEs per \$100 million of gross premiums written are, however, in excess of each of the comparator groups by 28 - 50 FTEs, and the Corporation's ratio of staff to management is lower than the comparator groups, meaning that the Corporation has more managers and less staff than the comparator groups, which leads to higher compensation costs.

MPI filed a benchmarking study relative to its IT expenditures, and an updated CIO Scorecard prepared by The Gartner Group (Gartner), reflecting benchmarking of various elements of IT costs. Gartner stated that MPI's overall IT maturity had improved from the prior year. Gartner noted that while there were some improvements in MPI's ratings as compared with its peer group, MPI spent 8% more on personnel, 9% more on outsourcing and used 12% more contractors than its peers. The disparity between MPI's spending and that of its peer group has, on the whole, improved over past years though MPI remains above its peer group in certain aspects of spending.

In particular, MPI's IT spending per company employee is \$44,046 (increased from \$43,243 last year), compared with the peer group for which average spending is \$27,073. Similarly, MPI's total IT spending, as a percentage of revenue, is down to 7.2% from 7.6% last year, compared with the peer group average of 4.6%. Gartner also noted that MPI's public mission to serve Manitobans, and not to maximize revenues, has an effect on the metrics reported as a percentage of revenue. Gartner has stated that as MPI adds more customer convenience capabilities and conducts more business over digital channels, its IT footprint will expand, resulting in higher steady-state IT expenses.

Gartner stated that improving MPI's long-term IT cost position is reliant upon retiring and/or eliminating duplicate functionality on an ongoing basis, in addition to regularly investing in updates to avoid significant capital outlays in future years. As well, it is critical that modernization and rationalization of IT are an ongoing part of MPI's governance process and investment strategies. Gartner has stated also that as the modernization efforts ramp down, staffing plans should be developed to ensure a core of key skills remain in-house at MPI to reduce contractor dependence, increase staff satisfaction and maintain costs.

Gartner has made a series of recommendations to MPI in the past, which MPI has not yet implemented, in some instances because MPI has rejected the recommendation, and in others because MPI lacks the resources to implement the recommendation. MPI has stated that it is continuing to work towards evaluation and implementation of many of Gartner's outstanding recommendations.

The Corporation did not file with the Board a five-year IT strategic plan, including a cost-benefit analysis, justifying its current and future IT expenditures, as ordered last year. Rather, the Corporation advised the Board that its IT strategy is integrated with its overall business strategy, and that it is conducting two strategy development exercises for its business, each of which includes an IT component. The first relates to the management of physical and property damage claims with a view to developing an overall strategy to enhance service. The second is the development of an overall vision and strategy for the Corporation for the next five years, to be developed by the Corporation's Board of Directors and Management Committee. The Board orders MPI to file, at next year's GRA, any reports generated relative to its vision and strategy development exercises.

3.7 Recycled Parts

The Board granted intervener status to the Automotive Recyclers of Manitoba (ARM), an organization that sought to bring forward important and cost-sensitive issues, and to critically evaluate the PDR Project, review cost containment initiatives relative to recycled parts, review environmental controls in the resale of total loss vehicles, and suggest improvements to reduce physical damage costs.

Since 2008 there has been a downward trend in the use of both aftermarket and recycled parts, in favour of the use of new or Original Equipment Manufacturers' (OEM) parts. The amounts spent on new, aftermarket and recycled parts from 2008 to 2013 is as follows:

Vehicle Parts Costs (\$ millions)

| Year | New | | Aftermarket | | Recycled | |
|------|-----|--------|-------------|--------|----------|-------|
| | % | \$ | % | \$ | % | \$ |
| 2008 | 56% | \$44.6 | 33% | \$26.4 | 11% | \$8.6 |
| 2009 | 55% | \$44.9 | 34% | \$27.4 | 11% | \$9.1 |
| 2010 | 59% | \$44.8 | 30% | \$24.7 | 10% | \$9.0 |
| 2011 | 61% | \$51.2 | 30% | \$27.6 | 9% | \$9.6 |
| 2012 | 62% | \$48.7 | 29% | \$26.2 | 8% | \$8.3 |
| 2013 | 67% | \$59.4 | 27% | \$24.2 | 7% | \$7.5 |

In the past, the Corporation had an agreement with ARM whereby the Corporation provided annual funding for the operation of the Recyclers' Central Office ("RCO") administered by ARM. The RCO acts as a clearing-house for all recycled parts requested by the Corporation, and automobile repair shops contact the RCO to determine the availability of recycled parts for the repair of damaged vehicles. MPI's agreement with ARM relative to the RCO expired on November 30, 2012, after which MPI took over the operation of the RCO.

Aftermarket parts are manufactured and supplied by sources other than the OEM. The Corporation has negotiated pricing, warranties, delivery time and business rules with the major parts suppliers, such that aftermarket parts are obtained at a discount off of the OEM suggested list price, resulting in cost savings to MPI.

The Corporation has observed the following industry trends impacting the availability of cost-effective alternative parts. OEMs have increased their new model marketing and introduced a much wider variety of models. These changes have reduced the interchangeability of parts among vehicles. The widened variety of models also impacts recyclers. For instance, a specific auto model in a recycler's inventory may not be compatible with the current model of the same vehicle being repaired.

Another major trend is the erosion of the relative dominance of North American vehicle brands as offshore vehicle manufacturers continue to grow their market share. Offshore brands have significantly different supply chain policies and methods and the ability of aftermarket suppliers to obtain the necessary information to produce comparable alternative parts is more constrained than for the North American brands. The Corporation sees that as more offshore brands grow their market share, the opportunity to purchase alternative parts has been and will continue to be reduced.

OEMs have introduced competitive strategies for price matching aftermarket and recycled parts and if the price is the same, customers have shown a preference for OEM parts. In addition, OEM Certified Repair Programs are further limiting repair facilities from using aftermarket or recycled parts and require the use of OEM parts only.

MPI has stated that it is committed to safe, reliable and cost-effective repairs to customer vehicles, and that while cost-effectiveness is important, MPI must also ensure that the parts used are of the appropriate quality. If market trends continue to reduce the ability of the local parts industry to provide qualified parts, MPI will have no option but to authorize the use of OEM supply parts. These trends have the potential to increase claims costs and will need to be factored into MPI's overall insurance program.

MPI stated that it works with 16 auto recyclers and that when the Corporation started the PDR Project, it met with these recyclers to discuss changes in technology, parts procurement and supply chain and the sustainability of the recycling industry. MPI stated that if market trends continue, auto recyclers are going to be defunct within five years given the aggressive aftermarket business. MPI stated that it will be required to make a policy decision whether to support the recycling industry, after weighing the impact on ratepayers and issues of sustainability.

3.8 *Intervenors' Positions*

CAC

CAC questioned whether MPI's IT investments are delivering value to Manitobans as promised, and whether the core strengths of MPI, including claims management and cost control, are being neglected in MPI's rush to IT solutions. In particular, CAC stated that from 2009/10 to 2013/14, the Corporation's IT costs increased by \$27 million; a compounded annual growth rate of almost 18%, and that from 2013/14 to 2018/19 there are expected increases of an additional \$23 million; a compounded annual growth rate of 7.1%. CAC noted that the forecast through 2018/19 does not include an additional \$3.5 million to be expended relative to the purchase of software pursuant to the PDR Project.

CAC stated that MPI is not conducting itself in a manner consistent with having suffered losses of \$133 million in the last two fiscal years, particularly given its compensation costs, including costs for outside consultants (\$30 million per year), the budget for which MPI stated clearly would not be changed.

CAC expressed the view that MPI seems to be moving sharply away from service centre control over the estimating process, and to management by exception, such that Board may wish to direct MPI to provide an updated estimate of the projected costs and benefits associated with the PDR Project including empirical information assessing this approach. CAC also recommended that MPI be directed to give advice to the Board on how barriers (including training) to cost-effective estimating and collision repair are being addressed. CAC identified this as an important risk mitigation issue.

CAC recommended also that MPI be directed to provide, at the next GRA, baselines in terms of duration of repair shop contact with MPI as well as preliminary metrics by which to assess cost containment achievements of the PDR Project.

CAC noted that last year the Board expressed a concern that the Corporation did not have in place a cost containment framework, although the BI³ Project was implemented in September 2010 and continues to function today. CAC submitted that the BI³ Project has not led to any success in controlling claims costs, increased consistency in claims handling between case managers or reductions in claims leakage as promised by MPI, and that in fact there has been deterioration in the Corporation's performance compared to pre-BI³ benchmarks.

CAC pointed to the following issues encountered relative to the BI³ Project, which issues it states affect PIPP reserving estimates and therefore cast doubt upon the credibility and reliability of some of the ultimate PIPP forecasts:

- Double reserving resulting in overstatement of certain reserves (addressed in November 2012);
- Lag in complying with case reserving guidelines gave rise to gaps in reserving that were more extensive than expected;
- Lag in complying with case reserving guidelines was identified by actuaries not claims managers through monthly reporting; and
- Deterioration in duration performance compared to pre-BI³ benchmarks.

CAC stated that there is still opportunity for improvement pursuant to the BI³ Project, but that in its view, MPI has not established that the BI³ Project has demonstrated its ability to control claims costs, or that there has been value received for the funds expended on the BI³ Project. CAC asked that MPI be directed to provide an update at the next GRA relative to the duration issue and management of PIPP claims that includes whether pre-BI³ benchmarks are being achieved, when higher post-BI³ benchmarks will be implemented and what those benchmarks will be.

CAC also requested that consideration be given to MPI undertaking an external, independent review of the management and oversight of PIPP claims pursuant to the BI³ Project.

CMMG

CMMG stated that MPI is not focused on controlling its costs. Rather it continues to pursue expensive IT projects.

ARM

ARM stated that recycled parts provide to MPI the largest discount by percentage of any other replacement part option. In particular, recycled parts are priced at between 45% and 60% of OEM rates, which represent savings passed on to ratepayers in their insurance premiums. At one time, MPI had a "recycle first" policy to ensure maximum savings on recycled parts and since the removal of that policy, MPI's costs for replacement parts have increased significantly. ARM asked the Board to recommend that a "recycle first" policy be maintained in any future arrangements between auto recyclers and MPI.

ARM stated that there has been a significant decline in the quantity of recycled parts sold, from 11% of all replacement parts purchased by MPI in 2008 to 7% in 2013, with a concurrent increase in the use of new (OEM) parts. ARM advised that it would like to work with MPI to reverse this trend or reduce the decline in the use of recycled parts, and to continue to offer a viable alternative to new parts. ARM asked the Board to recommend that MPI adopt a strong initiative to both foster and assist the auto recycling industry to assist it to remain viable and sustainable.

ARM also asked the Board to recommend that the development of the PDR Project be done by MPI in a co-operative and considered manner, together with ARM, including the automation of the parts processing and repair estimates. ARM stated that auto recyclers can work with MPI to reduce the parts-ordering timeline, and to eliminate redundancies within the system. ARM stated that recyclers can provide parts quickly and cheaply, to the benefit of all ratepayers.

ARM stated that when MPI took over responsibility for running the RCO in December 2012, it was on the basis that there would be a greater and more efficient use of recycled parts. ARM states that no such improvement has materialized, and asked the Board to recommend that MPI meet its pledge, and work with ARM to revisit operation of the RCO to ensure transparency and efficiency.

ARM advised that it has met with MPI to determine what changes can be made to the Canadian Automotive Recyclers' Environmental Code (CAREC) computer system, that effectively shuts out recyclers where there is a glass component in an insurance claim (or where the word "glass" is referenced relative to any replacement part), and where a required part is stored by recyclers as part of an assembly, rather than an individual part. ARM has stated that MPI has agreed to review and resolve these issues in consultation with ARM.

In addition, ARM is in discussions with MPI relative to reviewing the process by which the use of recycled parts can be rejected by body shops in Manitoba in favour of the use of OEM parts, which may increase the profit margin to the shops. ARM expressed confidence that MPI will resurrect its policy of monitoring the rejection of recycled parts that has contributed substantially to the decline in the use of recycled parts in Manitoba.

ARM stated that these types of joint activities as between it and MPI are critical to ensure that ratepayers receive the benefit of the use of the least expensive replacement parts, and maintain critical safety parameters. ARM also cited the importance of ARM and MPI working together to ensure a consistent set of practices that are aligned with applicable laws and regulations as well as within product and industry stewardship programs.

The Board also heard a presentation on behalf of ARM, by Mr. Stephen Fletcher, which is summarized in section 9.0 below.

IBAM

Mr. David Schioler, the CEO of IBAM, testified before the Board that IBAM represents 2,000 broker members from all communities in Manitoba, who are the sole distributors of MPI products, and that MPI sales represent approximately 33% to 35% of all insurance transactions processed by brokers in Manitoba. In 2013, brokers processed over \$3.7 million in transactions for MPI, for about 900,000 customers.

IBAM sought to raise awareness with the Board regarding the complexity of selling MPI's Basic and Extension products and to ensure that MPI has the funding envelope required to ensure the viability of professional insurance brokers. IBAM has worked collaboratively with MPI over the last eight years to ensure that costs would be managed effectively both at brokerage offices and at MPI without reducing the level of service that Manitobans expect. IBAM stated that ensuring that MPI has appropriate funding to facilitate training and product development, and to improve broker conditions will ensure the viability of brokers and provide protection and proper service to Manitobans.

IBAM stated that alternative delivery models such as MPI selling directly to consumers would surely prove cost-prohibitive and would be unacceptable in terms of the level of accessibility and service that Manitobans have come to expect.

IBAM stated that MPI has a shared responsibility to ensure that Manitoba customers are adequately covered with the best-fit insurance products for their needs, and that to do so, MPI must be in a position to manage effectively, to respond to changes in process, and to support brokers through research, training and feedback. IBAM stated that any rate premium deficiency must be addressed and that adequate capital requirements are very important for MPI.

With respect to MPI's dominant position in the Extension line of business, IBAM stated that MPI offers a good Extension product and that Basic customers are familiar with MPI and choose MPI's Extension products because they are attached to the Basic product.

3.9 Board Findings

The Board has in the past characterized one of the key elements of its independent review function and rate-setting role as ensuring that actual and projected costs incurred are necessary and prudent, in the context of setting just and reasonable Basic rates. The Board's jurisdiction to do so is derived from *The Crown Corporations Public Review and Accountability Act* and in particular s. 26 thereof, as reflected in Order 98/14 issued in this proceeding.

With respect to Operating Expenses, in last year's Order 151/13, the Board expressed the view that the Corporation's approach to operating expenses appeared to be unchanged from prior years. The Board expressed significant concern that there were no savings in operating expenses over the two years previous, and that the growth rate of expenses continued to be higher than inflation. The Board stated that the Corporation must control its expenses, and reverse the trend of ongoing growth in expenses over time. The Board also expressed concerns with respect to the Corporation's staffing levels, which had continued to increase.

The Board ordered the Corporation to review its efficiencies on a go-forward basis, and take steps to rein in its operating expenses. The Board ordered MPI to file with the Board staffing and cost control results at this GRA.

The Board accepts that in the last year, the Corporation has made more effort to contain costs than previously, and that it has established a specific set of strategies to do so including the creation of a cost containment committee, the implementation of a hiring freeze and the modification of certain internal expense policies. The Board is hopeful that these initiatives will moderate cost increases.

With respect to compensation, the Board recognizes that the collective agreement into which the Corporation entered with the MGEU in 2012 is a significant driver of cost increases in 2015/16, and that staff will receive step in scale increases as they gain seniority and progress in their employment by MPI. The Board finds that the hiring freeze and reduction in positions implemented by MPI have partially mitigated the Board's concerns about operating expenses as expressed in the past, though the Board expects to see MPI meet its minimum target of 30 FTE reductions by next year.

The Board notes MPI's submission that the increase in its normal operating expenses from 2014/15 to 2015/16 is 1.31%, less than inflation, and looks forward to seeing the outcome of MPI's cost savings initiatives next year, including the work of the cost containment committee formed this year.

With respect to IT expenditures, in last year's Order 151/13, the Board expressed significant concern about cost overruns, given the Gartner report filed which reflected that MPI had poor control over its IT spending versus peer groups and that even though its relative position has improved over past years, it remained at the high end of the peer group with respect to spending. The Board directed MPI to file at this GRA a five-year IT strategic plan, including a cost-benefit analysis, justifying its current and future IT expenditures which MPI did not do. The Board orders MPI to file an update at next year's GRA with respect to all initiatives that may have IT cost implications for Basic, including the five-year IT strategic plan and cost-benefit analysis as directed in Order 151/13.

With respect to the PDR Project, the Board orders that MPI file with the Board at next year's GRA:

- both the terms of reference and the outcome of the pilot project on "management by exception" collision estimating;
- an updated estimate of the projected costs and benefits associated with the PDR project including empirical information assessing the success of management by exception in terms of collision estimating as compared to other collision claims control options;
- an update on how barriers (including training) to cost effective estimating and collision repair are being addressed; and
- baselines in terms of duration of repair shop contact with MPI and preliminary metrics by which to assess cost containment achievements of the PDR Project.

With respect to benchmarking generally, the Board acknowledges that the Corporation has made progress again this year, and is doing more than it has before, including the presentation of a benchmarking framework as requested by the Board. Moreover, the benchmarking results presented by the Corporation from the Ward Group and Gartner reflect that its position relative to peers has improved from last year, for which the Board commends the Corporation.

With respect to the BI³ Project, the Board accepts that duration benchmarks are not being met, and that the Corporation has had challenges meeting pre-BI³ initiative duration expectations, as well as compliance in reserving guidelines. The Board directs MPI to provide, at next year's GRA, an update on the claim duration issue including whether pre-BI³ benchmarks are being achieved and when post BI³ benchmarks will be implemented and what those benchmarks will be.

The Board also orders MPI to undertake an external, independent review of the management and oversight of PIPP claims in the context of post-BI³ implementation, to learn whether the initiative is providing the desired impact, and file the result of the review at next year's GRA.

The Board encourages MPI to continue to conduct benchmarking relative to Serving Manitobans and Community Impact, and directs MPI to file updated results relative to that benchmarking with the Board at next year's GRA.

With respect to the use by MPI of recycled parts in the context of vehicle repairs, the Board recognizes the significant cost savings available to MPI, and strongly encourages MPI to work with ARM to address the ongoing use of recycled parts in Manitoba, to maximize savings to MPI, and in turn to ratepayers, wherever possible. In addition, the Board recognizes the benefit to MPI of the availability of recycled parts as an alternative parts source to OEM or aftermarket parts.

The Board accepts that joint activities as between ARM and MPI are needed to ensure that ratepayers receive the benefit of the use of the least expensive replacement parts, and maintain critical safety parameters. In addition, the Board supports ARM and MPI working together to ensure a consistent set of practices that are aligned with applicable laws and regulations as well as within product and industry stewardship programs.

Given the potential for cost savings to MPI arising from the ongoing and increased use of recycled parts, the Board accepts the submissions of ARM and recommends that:

- a "recycle first" policy be maintained in any future arrangements between auto recyclers and MPI, to ensure maximum savings relative to the use of recycled parts;
- MPI adopt a strong initiative to both foster and assist the auto recycling industry to assist it to remain viable and sustainable;
- the development of the PDR Project be done by MPI in a co-operative and considered manner, that engages ARM, including the automation of the parts processing and repair estimates; and
- MPI meet its pledge relative to the RCO, and discuss and examine the operations of the RCO with ARM to ensure transparency and efficiency.

4.0 INVESTMENTS

4.1 Investment Portfolio

As reflected in Section 2.4 above, the funds available for investment by the Corporation are primarily the assets supporting the unearned premium reserves and unpaid claims reserves. The Corporation's overall investment portfolio was over \$2.4 billion as at February 28, 2014.

Management of MPI's assets must be done in accordance with the Investment Policy Statement approved by its Board of Directors. The composition of the investment portfolio at February 28, 2014, and forecast for 2015/16 are as follows:

| | 2013/14 Actual | | 2015/16 Forecast | |
|----------------------------------|--|--|--|--|
| | Ending Asset Values (C\$ millions) | Ending Rebalanced Allocation (%) | Ending Asset Values (C\$ millions) | Ending Rebalanced Allocation (%) |
| Cash/Short Term Investments | 93 | 3.8 | 25 | 1.0 |
| Canadian Fixed Income | 970 | 39.7 | 792 | 32.3 |
| MUSH Non-Marketable Bonds* | 581 | 23.7 | 614 | 25.1 |
| Total Long Term Bonds | 1,551 | 63.4 | 1,406 | 57.4 |
| Canadian Equities | 381 | 15.6 | 439 | 17.9 |
| US Equities | 139 | 5.7 | 160 | 6.5 |
| Real Estate | 231 | 9.4 | 305 | 12.5 |
| Infrastructure & Venture Capital | 52 | 2.1 | 114 | 4.7 |
| Total | \$2,447 | 100.0% | \$2,449 | 100.0% |

* MUSH bonds are Manitoba rural municipality, school division and healthcare facility bonds and ventures which are not tradable in the fixed income market. MUSH bonds are held at book value and the portfolio's value does not vary with changes in interest rates.

In Order 151/13, the Board expressed some concern over the composition of the investment portfolio, noting the size of the portfolio and changes in the interest rate environment during the last five years. The Board ordered MPI to have the composition of its investment portfolio reviewed by an external expert consultant, with a view to determining whether the current asset mix should continue, or should be revised. The Board stated also that the review should encompass an examination that generates recommendations for improving the management of the portfolio, including strategies to manage the volatility of the portfolio, one of the major risks faced by the Corporation.

As directed by the Board, MPI has retained an outside consultant, AON Hewitt, to undertake an Asset Liability Matching Study (ALM Study) and advise whether the current asset mix and duration matching strategy should continue, or should be revised. The ALM Study is underway currently and is expected to be completed by the end of 2014/15.

4.2 *Investment Management*

Basic premiums are not set to recover claims costs; rather MPI depends on investment income to break even. MPI's substantial investment portfolio is managed jointly by the Corporation and the Province of Manitoba, through a committee known as the Investment Committee Working Group (ICWG), which is co-chaired by MPI's Vice President of Finance and Chief Financial Officer, and the Assistant Deputy Minister to the Department of Finance.

The ICWG provides support and advice to the Minister of Finance with respect to MPI's investments, including with respect to MPI investment strategies. The ICWG seeks consensus between the Department of Finance and MPI on recommendations to be provided to the Minister of Finance on investment decisions. Last year, the Assistant Deputy Minister to the Department of Finance advised the Board that the ICWG is responsible for MPI's investment returns, but that ultimate responsibility rests with the Minister of Finance.

4.3 Investment Returns

Basic realized investment income of \$147.7 million in 2013/14, an increase of \$79.6 million from 2012/13, including \$98.7 million in equity gains on its Canadian and U.S. equity portfolios, offset by \$13.5 million in unrealized losses in its fixed income portfolio, due to changes in interest rates. As at September 30, 2014, MPI had \$111.7 million in unrealized gains in its Canadian and U.S. equity portfolios. MPI has not directed that these investments be sold to realize gains, stating that to do so would negatively impact its investment income forecast through the outlook period.

MPI had originally projected investment income for Basic of \$28.8 million for 2014/15 and \$49.9 million for 2015/16. MPI now projects investment income for Basic of \$74.4 million for 2014/15 and \$23.7 million for 2015/16. These changes in forecast investment income are attributed to an October 2014 interest rate forecast update, which indicates lower forecast changes in interest rates. The subject of interest rate risk is addressed in the following section.

4.4 Interest Rate Risk

At the request of MPI, PricewaterhouseCoopers (PWC) reviewed the issue of interest rate risk to the Corporation. PWC has defined interest rate risk as follows:

Interest rate risk represents the risk of economic loss resulting from market changes in interest rates and the impact on interest rate sensitive assets and liabilities. Interest rate risk arises due to the volatility and uncertainty of future interest rates.

Within MPI's investment portfolio, due to its weighting to long-term bonds, some of which are marketable, investment returns are impacted materially by changes in interest rates. In particular, if interest rates increase, marketable bond values fall, as do the discounted value of the claim liabilities. If interest rates decrease, bond values and claims liabilities increase. The effect of these changes can, to a large extent, largely offset each other if managed appropriately so that the net impact on financial results is neutralized. If there is a mismatch between the duration of claims liabilities and supporting investment assets, as is the case currently, the net effect can mean increased gains or losses relative to a neutral situation, including a negative impact on net income. The same is true if there is a mismatch between the underlying forecasted cash flows (claims liabilities vs. supporting investment assets) even if the durations are matched.

If interest rates decrease relative to the forecast used to support a rate application, mismatching of durations will have an adverse effect if claims liabilities are longer in duration than the supporting investment assets, as is currently the case. When the increase in the value of the bonds is less than the increase in the value of claims liabilities, financial results will be worse than anticipated and, as a consequence, could lead to a need for increased Basic insurance rates.

MPI models changes in the fair market value of its marketable bonds and the changes to bond values flow through Basic's net income because those assets are categorized as Fair Value Through Profit and Loss. Basic's operating results are very sensitive to interest rate changes, including the timing and the amount of the interest rate changes. Because it is difficult to predict the amount and timing of assumed interest rate changes, Basic net income is very difficult to forecast accurately.

Duration matching of investments and claims liabilities does not mean that net income is immunized against interest rate changes, since only average durations are being matched, not the cash flows underlying those durations. Matching cash flows is a more complex and a more effective alternative in order to immunize Net Income.

The effectiveness of duration matching for the Corporation is also complicated by the fact that its investment portfolio is managed for the Corporation as a whole, rather than Basic's portfolio being separately managed. Further, a significant part of the fixed income portfolio supporting the claim liabilities is invested in non-marketable (i.e., MUSH) bonds, which are not interest rate sensitive (their value does not fluctuate with changes in interest rates).

MPI states that the longer the duration mismatch (with assets shorter term than liabilities), the more favourable the results for the Corporation if interest rates rise (the drop in value of the assets is less than the decrease in liabilities).

PWC, in reviewing the practices of Property and Casualty companies in managing interest rate risk, found that cash flow matching is the predominant methodology employed among its sample group. The majority of companies/branches sampled matched their assets to the claims liabilities to minimize interest rate risk.

The Board identified the interest rate risk faced by MPI last year and stated in Order 151/13, on p. 32:

It is the view of the Board that the Corporation's current approach to duration mismatching makes it too vulnerable to interest rate risk. The Board believes that the Corporation should match exposures, including cash flow, beyond duration matching on a go-forward basis. The Board directs MPI to submit a discussion paper of the duration matching of its claims liabilities and investments as part of the next GRA.

MPI provided a Duration Matching Discussion Paper in which it evaluated the interest rate risk faced by MPI. MPI found that the interest rate risk to the Corporation is more significant with a larger duration bandwidth. MPI analyzed the impacts of both a 1% increase and a 1% decrease in interest rates. MPI found that in a 1% interest rate increase scenario, changing the duration gap from -2 to -1 years reduced the positive impact on Basic net income from \$42.8 million to \$37.9 million, a \$4.9 million difference which represents a reduction in gains or, expressed otherwise, the opportunity cost of reducing the duration gap in a rising interest rate environment. In a 1% interest rate decrease scenario, changing the duration gap from -2 to -1 years reduced the negative impact on Basic net income from (\$57.2) million to (\$40.7) million, reducing the downside net income impact or loss by \$16.6 million. In other words, losses from the mismatch when rates are falling exceed the gains when rates are rising.

As a result of this analysis, the Corporation's Investment Policy Statement which previously allowed for a duration mismatch of up to +/- 2 years was changed to +/- 1 year on or about August 31, 2014. MPI has characterized this change as a stopgap measure pending the completion of the ALM Study underway currently, which study will address the merits of cash flow matching within the Corporation. The Board orders MPI to file the ALM Study with the Board at next year's GRA together with its proposed course of action at which time the merits of cash flow matching will be discussed.

As such, MPI continues to position itself such that the average duration of bonds is less than the average duration of claims liabilities because it expects that interest rates will increase. This means that an increase in interest rates will benefit Basic's net income, because the drop in value of marketable bond investments will be less than the decrease in value of discounted claims liabilities.

4.5 Investment Income Forecasting

Last year, the Corporation proposed a new methodology by which to forecast its investment income, which measured the impact of interest rate changes on investment income and claims liabilities, whereas the methodology employed by the Corporation previously did not do so. In addition, the methodology proposed by the Corporation last year utilized a five-year growth forecast from the five major Banks and Global Insight but projected that forecast growth over ten years, effectively halving the growth rate (Low Growth Rate Forecasting Methodology).

The Board concluded that there should be more discussion and analysis with respect to interest rate forecasting and pursuant to Order 151/13 ordered that a technical conference take place for that purpose. After learning that the Corporation would attend a technical conference but would not bring forward expert evidence, the Board varied Order 151/13, withdrew the requirement of a technical conference and ordered that at this GRA the following evidence be filed:

- the particulars of the interest rate forecasting methodology preferred by MPI and relied upon in the Application;
- the particulars of the research, review and analysis conducted by MPI in ascertaining the details of its preferred interest rate forecasting methodology; and
- expert evidence regarding a reasonable and appropriate interest rate forecasting methodology to be used by MPI.

In the Application, MPI advised that it continues to hold the view that interest rates will not rise as forecast by the Banks and other experts, given the history of forecast interest rate increases over the last number of years which have not materialized. MPI provided an updated interest rate forecast, as at October 2014, which reflects a 75 basis point lower forecast growth rate in interest rates in 2014/15 and a 51 basis point lower forecast growth rate in interest rates in 2015/16. Given its current duration mismatch position, MPI is now forecasting larger losses in 2014/15 and 2015/16, warranting the need for a 3.4% rate increase.

MPI continues to hold the view that the Low Growth Rate Forecasting Methodology should be utilized, though the forecasts within the Application were not prepared on that basis. The Corporation acknowledged that it does not have expertise in interest rate forecasting but stated that it has an in-depth understanding of the interest rate risks which it faces. The Corporation acknowledges that the GRA must be prepared on a best estimate basis.

MPI has stated that the net financial results for Basic are at significant risk if interest rates remain the same or decrease. In particular, if interest rates do not increase from the October 2014 level, Basic is expected to suffer a net loss of \$103.3 million in 2014/15. This scenario would give rise to an indicated 8.6% break-even rate requirement for 2015/16. If interest rates increase prior to the close of the 2014/15, MPI's financial position will improve.

4.6 *Interveners' Positions*

CAC

CAC stated that the October 2014 standard interest rate forecast should be utilized for forecasting purposes, as opposed to the March 2014 forecast included within the Application. CAC also stated that the Low Growth Rate Forecast Methodology put forward by MPI should be rejected, as it was not supported by independent expert evidence and has not been demonstrated to be the best estimate of interest rates.

CAC stated that there has been excessive variability in MPI's investment income over past years, as well as material changes in unrealized gains on equity investments. CAC raised concerns regarding the sharp changes in MPI's overall investment income forecasts, and stated that these forecasts should be reviewed with caution. CAC requested that MPI be ordered to provide a comparative assessment including back-testing of its investment income forecast methodology as compared with other alternatives including but not limited to the five year rolling average approach considered during the 2012 GRA.

CAC has been urging some caution in terms of a potential upward bias in interest rate forecasting. CAC recommended that MPI support its proposed methodology by running it and similar versions against a consensus forecast or current consensus forecast approach and by doing a fairly substantial period of back testing. CAC noted that if the Board wished to revisit the interest rate forecasting methodology of the Corporation it should consider the approach recommended by the Board for other regulated entities such as Manitoba Hydro and Centra Gas. CAC stated that MPI should be directed to provide a comparative report of different interest rate approaches supported by back-testing, dating back at least one decade.

CAC stated that pursuant to the duration gap utilized by the Corporation at present, there is a disproportionate downside risk to Basic arising from declining interest rates. CAC stated also that Basic has suffered material losses to date due to the previous duration gap of +/- 2 years, which MPI evidently maintained prior to August 31, 2014 due to a hope that interest rates would rise. CAC stated that MPI is continuing to bet on interest rate risk through the ongoing duration mismatch even though MPI's President testified that he does not believe interest rates will increase.

CAC stated also that MPI has shown that it has faced challenges in adhering to the previous +/- 2 year bandwidth in some quarters, and that it should be directed to provide at the next GRA a report demonstrating compliance with the current +/- 1 year duration gap on a quarterly basis.

4.7 Board Findings

With respect to the composition of the Corporation's investment portfolio and its management of interest rate risk, the Board looks forward to receipt of the ALM Study to be completed by AON Hewitt in early 2015 pursuant to the Board's order last year, with a view to determining whether the current asset mix and duration matching strategy should continue, or should be revised. The Board ordered that the review should encompass an examination that generates recommendations for improving the management of the portfolio, including strategies to manage the volatility of the portfolio, given that the volatility in the value of the investment portfolio is one of the major risks faced by the Corporation.

The Board notes that the Corporation has not adhered on a consistent basis to the duration gap reflected in its Investment Policy Statement (IPS). Last year, it was apparent that MPI was holding cash in excess of the allowable range provided in the IPS. The Board states, as it did last year, that in instances wherein the provisions of the IPS are exceeded, either the IPS should be revised, or a specific process should be triggered whereby an exception to the parameters of the IPS is reviewed and approved through a formal process with clear delegated authorities for the individuals involved.

In the view of the Board, it is not appropriate for MPI to speculate on increasing interest rates, thereby risking ratepayers' funds. The existing asset/liability mismatch has already caused the Corporation to suffer significant losses in the last number of years which the Board is not able to quantify, but which could have been avoided had the existing mismatch been fully or partially mitigated. MPI should seek to substantially immunize itself from the impact of changing interest rates. The Board applauds the Corporation's decision to reduce its duration mismatch from +/- 2 years to +/- 1 year, implemented on August 31, 2014, but finds that the Corporation's current approach to duration mismatching continues to make it too vulnerable to interest rate risk, particularly given that interest rates may decrease further prior to the end of 2014/15 (and the Board notes that the Corporation rejects interest rate forecasts which suggest impending increases). The Board continues to believe that the Corporation should match exposures, including cash flow, beyond duration matching on a go-forward basis.

The Board finds that the Corporation should seek to manage interest rate risk rather than attempt to predict how interest rates will change, and notes that pursuant to evidence filed by the Corporation, informed by PWC, "cash flow matching is an alternative solution to manage the Corporation's interest rate risk". The Board also notes that if the Corporation's interest rate risk is eliminated or substantially mitigated, there will be an impact upon the Combined Scenario in the Dynamic Capital Adequacy Testing (DCAT) report such that required rate reserve levels could be decreased.

Once the ALM Study is completed MPI must take steps to substantially mitigate interest rate risk, and the Board directs MPI to provide, at next year's GRA, the details of the steps that MPI has taken to do so.

The Board agrees with CAC that the Board should consider the most recent interest rate information available for rate-setting purposes, and as such the Board accepts the forecasts for Basic that include the updated October 2014 interest rate forecast. It is the view of the Board that the standard interest rate forecast prepared by the 5 major Banks and Global Insight is the best information that is available with respect to interest rate forecasts, other than longer term forecasts available for purchase, which MPI has not done.

MPI has stated that it has no expertise in interest rate forecasting, and has submitted no evidence to support the submission that the Low Growth Rate Forecasting Methodology represents a best estimate and should be accepted. As such, the Board is not in a position to accept the Low Growth Rate Forecasting Methodology.

The Board notes that if the rates projected in the updated October 2014 standard interest rate forecast do not materialize, MPI's revenues will decrease, and result in a further decrease to the RSR balance. The Corporation will have mitigated the impact of that decrease by transferring funds to the RSR retained earnings from the Extension and SRE lines of business.

The Board notes also that the Corporation has available unrealized gains within its equity investment portfolio, of over \$110 million as at September 30, 2014; the Corporation could choose to trigger some or all of those gains to bolster the net financial result of Basic in 2014/15.

5.0 RATE STABILIZATION RESERVE

5.1 *RSR Balance*

The stated purpose of the RSR is to protect motorists from rate increases made necessary by unexpected events and losses arising from non-recurring events or factors. The RSR balance was \$99.9 million as at February 28, 2014, after a net loss in Basic of \$69.1 million. With Accumulated Other Comprehensive Income (AOCI), Basic Total Equity was \$170.2 million as at February 28, 2014. AOCI represents an aggregate of the difference between net income reflected in an income statement and comprehensive income, and includes unrealized gains or losses on available for sale securities, among other gains and losses in the investment portfolio.

A summary of the retained earnings balances for the Corporation from 2012/13 through 2016/17, prepared on the basis of the October 2014 standard interest rate forecast, is as follows:

| | Actual | | Forecast | Projected | Outlook |
|--|--------------|---------------|----------------|----------------|----------------|
| Years Ending February 28/29 | 2013 | 2014* | 2015 | 2016 | 2017 |
| RSR opening balance | \$232 | \$169* | \$100 | \$17 | \$19 |
| Net income (loss) | (\$63) | (\$69)* | (\$83) | \$2 | (\$6) |
| Total Basic RSR | \$169 | \$100* | \$17 | \$19 | \$13 |
| Other Basic Retained Earnings | \$0 | \$0 | \$0 | \$0 | \$0 |
| Basic AOCI | \$57 | \$70 | \$71 | \$78 | \$86 |
| Total Basic Equity | \$226 | \$170 | \$88 | \$97 | \$99 |
| | | | | | |
| Non-Basic Capital Reserves | \$72 | \$114 | \$114** | \$114** | \$114** |
| Non-Basic Retained Earnings | \$124 | \$107 | \$107** | \$107** | \$107** |
| Non-Basic Retained Earnings | \$196 | \$221* | \$221** | \$221** | \$221** |
| | | | | | |
| Total Corporate Retained Earnings | \$365 | \$321* | \$238 | \$240 | \$234 |
| AOCI (includes Basic) | \$65 | \$77 | \$78 | \$85 | \$92 |
| Total Corporate Equity | \$430 | \$397* | \$316 | \$325 | \$326 |

* Restated due to the implementation of International Accounting Standard (IAS) 19, Employee Benefits, in 2013/14 which required actual gains and losses on employee future benefits to be recognized immediately in Other Comprehensive Income. The impact of this change was to increase the RSR by \$27.6 million to \$99.9 million as at February 28, 2014.

** Forecast information for competitive lines is not provided. For the purposes of this analysis, the Board has assumed no change in the other retained earnings from 2013/14, based on the information contained in MPI's 2013 Annual Report.

On February 28, 2014, the Corporation had corporate retained earnings of almost \$321 million, including all lines of business, and \$397.3 million in total equity including AOCI. Based on the October 2014 interest rate forecast, MPI is projecting the RSR to be \$19 million in 2015/16 and total equity to be \$97.4 million. In the Application, MPI has requested that the Board approve a minimum (lower) RSR target of \$194 million in retained earnings or a minimum (lower) RSR/capital target of \$213 million in total equity (recommended by the Corporation), each based on its 2014 DCAT Report. The Corporation has also requested that the Board approve an upper RSR/capital target of \$323 million or \$325 million based upon a 100% Minimum Capital Test (MCT) value.

Appointed actuaries for federally regulated property and casualty insurance companies in Canada are statutorily required to annually report on an investigation of the expected future financial condition of the entity (Section 368 and 630 of the *Insurance Companies Act of Canada*). The Dynamic Capital Adequacy Test (DCAT) is the process developed by the Canadian Institute of Actuaries (CIA) to address this statutory requirement. Actuaries carrying out a DCAT are expected to do so in accordance with accepted actuarial practice in Canada. Through the examination of plausible adverse scenarios for each of a number of relevant risk categories, the purpose of DCAT is to identify:

- Plausible threats to an entity's satisfactory financial condition;
- Actions which lessen the likelihood of those threats; and
- Actions that would mitigate a threat if it materialized.

The DCAT process can also be adapted for purposes of estimating target capital levels, which in the case of Basic coverage may be defined in terms of the RSR balance or the Basic Total Equity balance. A target capital range can be defined by selecting a lower and upper percentile level of possible outcomes, each consistent with a level of protection one intends the target capital level to provide.

MPI stated that the DCAT should be adopted now, as is, to form the basis of the RSR/capital target range. MPI stated that the DCAT addresses the risks faced by MPI, and that the Board's actuarial advisor could propose refinements to the adverse scenarios within the DCAT which MPI would accept, if its internal and external actuaries approved of the changes. MPI submitted that any such refinements should not delay the Board's acceptance of the DCAT for the purposes of setting the RSR/capital target range, as there is sufficient consensus between the parties with respect to the DCAT to initiate its use. MPI stated also that any changes to be suggested by the Board's actuarial advisor would not materially change the proposed RSR/capital target range.

MPI stated that the MCT is designed to assess the key risks faced by the property-casualty insurance industry, the majority of which are relevant to MPI, and that it is used by all other property-casualty insurers in Canada, including the Saskatchewan Auto Fund and the Insurance Corporation of British Columbia. MPI stated that the MCT assesses the riskiness of assets, policy liabilities and off-balance sheet exposures by applying a consistent set of factors that were agreed upon by a task force of insurance experts, and that the MCT identifies MPI's risk profile based on current financial statements. MPI stated also that the calculation of the MCT score is completely objective, involves no judgment and is relatively easy to calculate.

MPI stated that its proposal of using a 100% MCT ratio as the maximum, not minimum RSR/capital target, is lower than for any private insurer, and is a reasonable methodology to calculate the maximum RSR/capital target. MPI has requested that a 100% MCT ratio be implemented as the maximum RSR/capital target for the next four year period.

5.2 RSR Target History

Historically, the Corporation and the Board have held differing perspectives on the appropriate target amount for the Basic RSR, and at various GRA hearings the Board has heard evidence on which of a variety of methodologies should be used to set the RSR target amount.

In Order 161/09 the Board reset the RSR target based on the "Kopstein" approach (the 1989 Report of the Autopac Review Commission, commonly referred to as the Kopstein Report), of 10 - 20% of net written premiums (vehicle and driver premiums), on the basis that this methodology would be clearly understood by all parties. The RSR range established pursuant to this Order was \$77 million to \$154 million, and the Board also ordered that each of the DCAT Report, the MCT Report and the Risk Analysis/Value-at-Risk Report be filed with the Board on no less than a triennial basis to test against the RSR established target.

The Corporation stated that the current target range for the RSR, set on the basis of the Kopstein approach, is insufficient to meet the plausible risks faced by the Corporation. In particular, MPI stated that a percentage of premiums approach does not address the risks faced by MPI and that it is an outdated methodology.

In each of Order 157/12 and Order 151/13, the Board stated that the DCAT methodology is an improved approach for determining the RSR target over the Kopstein methodology, however, the Board found that further analysis and discussion was needed, particularly in relation to the adverse scenarios used in the DCAT and the methodology construct, before the DCAT should be utilized for RSR target rate-setting purposes. The Board ordered that a Technical Conference take place as between the parties to the GRA, with a view to refining the adverse scenarios and gaining a better understanding of the DCAT modeling process.

That Technical Conference commenced on April 18 and 19, 2013, and continued on April 24, 2014 at which time the Corporation provided a walk-through of its financial model. Both the Corporation and CAC have advised that the Technical Conference was a useful process and has given rise to an improved understanding of the Corporation's DCAT process.

MPI stated that while total equity including AOCI should be considered for the purposes of setting the minimum target of the RSR, comprehensive income should not be considered for rate setting as it does not represent real (realized) income, and that to do so would result in higher volatility in rates.

5.3 RSR Rebuilding Fee

Pursuant to the Application, the Corporation sought a 1% RSR rebuilding fee on each Basic vehicle premium, effective March 1, 2015 (together with the overall 2.4% rate increase). The Corporation included in the projections in the Application an ongoing 1% per year RSR rebuilding fee through the outlook period, which totaled \$31 million through 2018/19. In support of the request for an RSR rebuilding fee, MPI cited the vulnerability of the Basic financial position evidenced by the losses suffered by Basic in each of the last two fiscal years, totaling \$132 million, as a result of which the RSR was, at the time of filing the Application, forecast to be \$61.8 million as at the end of 2014/15, which would be under the Board's minimum target range of \$82.3 million.

Over the course of the GRA hearing, the Corporation put forward to the Board an alternative position; that instead of an overall 2.4% rate increase and 1% RSR rebuilding fee, the Board should grant an overall 3.4% rate increase.

5.4 *Interveners' Positions*

CAC

CAC stated that there is a lack of clarity for consumers relating to the purpose and use of the RSR, and that its stated purpose should be clarified. Although the definition of the RSR has remained the same for many years, CAC questioned whether the RSR is actually utilized for its stated purpose, and stated that the RSR should be utilized for only an extreme event.

With respect to the RSR target range, CAC stated that excess reserves within any organization may encourage imprudent expenditures, for example IT expenditures or the taking on of additional risks, for example excess duration mismatch risk. CAC stated that an RSR range equivalent to a 1-in-20 year to 1-in-40 year event is sufficient.

CAC stated that while the DCAT has progressed over time, it has not yet advanced to the stage of being used for RSR target setting purposes, and that discussion on its use should continue.

CAC stated also that MPI was required to employ substantial judgment in the interest rate and combined scenarios within the DCAT, and that while those scenarios are not entirely impossible, CAC does not accept that they represent 1-in-40 year events. CAC believes that the scenarios represent much more remote events. With respect to the proposed maximum RSR target requested by MPI, CAC stated that while \$325 million would enable Basic to absorb much more risk and withstand adverse events without having to make hard decisions, such a large RSR is unnecessary given MPI's monopoly in Basic.

CAC stated that the existing DCAT cannot be relied upon to set a reasonable RSR range at 1-in-20 year to 1-in-40 year confidence levels. In particular, CAC identified three analytical challenges with the interest rate and combined scenarios through its witness Dr. Wayne Simpson:

- the use of a zero lower bound of nominal interest rate renders both the stagflation data and the distribution developed from the data of little or no value;
- the methodology used to select the floor was based on a bad month or a bad day which does not support a four year floor; and
- a negative yield floor or neutral yield floor is not sustainable for four years in the North American marketplace.

CAC submitted that the Corporation should explore DCAT interest rate scenarios on a basis which addresses these analytical challenges and that further consultation with Board advisors and interveners should take place, to consider whether the combined scenario should include a more robust combination of variables. CAC did not submit that the DCAT technical conference should continue but rather that there should be follow up via correspondence or telephone.

CMMG

CMMG stated that the RSR has no applicability to motorcyclists, and has never been used to cushion a rate increase requested for the motorcycle class, such that the motorcycle major class should not have to assist in rebuilding the RSR. CMMG stated also that the areas stressing the RSR are not motorcycle-related, including the difficult winter of 2013/14, the technological changes in vehicles and the potential for a major hailstorm. CMMG stated that to require motorcyclists to contribute to the RSR would be unfair and inequitable.

CMMG stated that the RSR target should be set by looking at the history of the RSR, as well as the Corporation's large investment portfolio and the fact that the Corporation is backstopped by the Province of Manitoba. CMMG stated that the proposed range of \$194 million to \$325 million is too large and unnecessary for the Corporation to fulfill its mandate.

CAA

CAA stated that whatever methodology is utilized to set the target range of the RSR, that methodology, any RSR rebuilding and any usage of RSR funds should be communicated clearly and should be transparent to ratepayers in order that the average ratepayer can understand.

5.5 Board Findings

As set out in Section 2.7 above, the Board has ordered that no RSR rebuilding fee be imposed at this time, and that an overall 3.4% rate increase be ordered. Although the rate order requested pursuant to the Application (2.4% overall rate increase + 1% RSR rebuilding fee) and the alternative position put forward by MPI (3.4% overall rate increase) each total an overall increase of 3.4%, there are several differences between the two approaches, including:

- in the 3.4% overall rate increase scenario, the increase is embedded in rates going forward, subject to change annually pursuant to rate orders from the Board;
- revenue collected pursuant to an RSR rebuilding fee would be tracked separately by the Corporation from premium revenue, and would also be subject to change annually pursuant to rate orders from the Board; and
- a flat percentage RSR rebuilding fee would be charged to all ratepayers at the same percentage, whereas an overall rate increase is funded by all ratepayers pursuant to capping and other adjustment rules, such that ratepayers subject to capping of increases pay less pursuant to an overall rate change than pursuant to a flat percentage RSR rebuilding fee.

The Board does not accept that any one vehicle class, including the motorcycle class, should receive different treatment than other classes with respect to the rate indications, or with respect to the RSR. When premium rebates have issued from the RSR in the past, all vehicle classes have received the same percentage rebate. The fact is that as it is utilized at present, the RSR represents a cushion for the net overall financial result to Basic in a given year, including all major vehicle classes. At this year's hearing, there was some discussion relative to the stated purpose of the RSR and whether that purpose is met pursuant to the manner in which MPI utilizes the RSR. Next year, the Board may examine further the stated purpose of the RSR as a component of Basic retained earnings and consider whether changes are required to the RSR definition or accounting. To that end, the Board orders MPI to prepare and file, at next year's GRA, a discussion paper relative to these issues, based upon the comments at this year's hearing about confusion relative to the nature and purpose of the RSR, including the term "RSR".

The Board appreciates that the motorcycle class has experienced fluctuations in rates historically, but recognizes that over the years measures have been taken to mitigate those changes, including capping and loss transfer pursuant to Board Order 97/05. The Board finds that the overall rates charged to the motorcycle class over the last number of years have been just and reasonable, within the context of overall Basic rates.

The Board accepts that an RSR target range is preferable to an RSR target point, because a range provides enhanced rate stabilization and more rate setting flexibility. The Board recognizes, however, the merits of achieving an actuarial opinion of a satisfactory future financial condition; when rate reserves fall below this amount, it should trigger a response by MPI to improve reserve levels using the full inventory of means at its disposal, but which respects the overarching goal of rate stability. When reserve levels are below the bottom end of the target range more vigorous and timely actions will be required. Included in the actions available to MPI are cost cutting measures, delaying of expenditures, early realization of available investment gains (since these gains can also be used to moderate rate increases) and transferring of excess reserves from other lines of business to Basic.

The Board notes that in each of Order 157/12 and Order 151/13, it stated that the DCAT methodology is an improved approach for determining the RSR target over the current methodology, though further analysis and discussion was needed before the DCAT should be utilized for RSR target-setting purposes. The Board finds that the need for further discussion relative to the DCAT is ongoing, and may remain ongoing for some time, pending the achievement of a satisfactory methodology construct and adverse scenarios.

In the context of further discussion regarding the DCAT, the Board provided to MPI a draft undertaking, to which MPI responded at the GRA hearing. During the hearing, the Board agreed to provide to MPI further context with respect to the draft undertaking, and that context is now provided to all parties, attached to this Order as Appendix E, in order that an ongoing discussion relative to the DCAT can continue.

For the purposes of this Order, and Fiscal 2015, the Board accepts the DCAT methodology, in principle but on a preliminary basis, for the purposes of establishing the RSR target range for Basic. For the time being and subject to further analysis, the Board accepts that a 1-in-40 year scenario probability level, as requested by MPI, is the appropriate threshold for the minimum RSR target for 2015/16. The Board also accepts that the minimum RSR target should be based on total equity, given the impact of unrealized equity investment gains within AOCI. With respect to the specific dollar amounts that should form the minimum and maximum RSR/capital target range, the Board orders that further work be carried out.

The Board orders that MPI respond to the document attached at Appendix E hereto, including any proposed changes, in writing, promptly and with a copy to all interveners. Thereafter, the Board is supportive of an ongoing dialogue, in person and/or in writing, among all parties relative to Phase I of Appendix E on an open and transparent basis, and with notice to all interveners, with a view to finalizing Phase I, after which the Board can decide any required issues relative to Phase I. Thereafter, Phase II can proceed, also pursuant to an ongoing dialogue among all parties, on an open and transparent basis. Phase II must be completed prior to the preparation of MPI's 2015 DCAT report to be filed together with the 2016 GRA, in order that the RSR minimum and maximum target range can be set. The Board finds that MPI cannot know now, and prior to completion of the analysis, that the changes suggested by the Board's actuarial advisor would not materially change the approved RSR/capital target range. The Board directs MPI to consult with all parties and file with the Board a proposed schedule pursuant to which all of these steps will be completed.

The work to be done over the coming year relative to Appendix E, as detailed above, is intended to result in a better understanding and acceptance of the plausible adverse scenarios and is expected to assist the Board to establish an appropriate Basic RSR/capital target range for the future with more confidence.

For 2015/16, the net financial results in Basic in 2014/15 will determine the RSR balance. The Board understands that the forecast RSR balance will change given movement in interest rates along with other operational factors that will occur between now and the end of 2014/15, and in 2015/16. The Board notes that pursuant to the Kopstein approach utilized by the Board historically, the Board's RSR target range for 2015/16 would be \$89 million to \$177.7 million, and that MPI's proposed RSR target range for 2015/16, as reflected in the Application, is \$194 million (RSR based) or \$213 million (total equity based) to \$323 million or \$325 million (100% MCT ratio based).

So while the target range will not be finalized until next year's GRA, the Board concludes that irrespective of the calculation methodology, whether the Board's range or MPI's range, it is apparent that the current financial position of Basic and the financial forecasts prepared by the Corporation reflect an RSR balance that will be far too low and will need to be increased from current forecast levels.

The Board finds that the Corporation has provided insufficient context for its choice of a 100% MCT ratio for the maximum RSR/capital target, only stating that 100% is a lower ratio than those utilized by other insurers in Canada. As such, the Board does not approve the use of a 100% MCT ratio to set the maximum RSR/capital target. The Board also notes that pursuant to the document attached as Appendix E, prior to the maximum RSR/capital target being set, a determination should be made as to what probability level should be utilized to define that target. Given the projected RSR balance, and in the absence of any unforeseen circumstances, it is apparent at this time that no rebate will be considered next year, such that a maximum RSR/capital target is unnecessary for 2015/16. The Board finds, however, that the MCT is a valuable yardstick that can be utilized to measure MPI's capital adequacy at different points in time for comparative purposes, and orders that MPI file with the Board on a go-forward basis Basic MCT calculations for all years for all scenarios within the annual DCAT report.

As in the past, the Board looks to the overall financial strength of the Corporation in establishing rates. The Board notes that, even though Basic financial results and reserves need to be addressed, on an overall basis MPI is still in a financially strong position with retained earnings of over \$320 million as at February 28, 2014 and \$358 million as at August 31, 2014, including \$188.9 million in Extension and \$60.7 million in SRE.

In prior years, the retaining earnings targets in Extension and SRE were \$35 million and \$37 million respectively by MPI. For 2013/14, those targets were increased to \$72 million and \$42 million respectively by MPI. Because the Board does not have jurisdiction over Extension and SRE, it cannot evaluate the reasonableness of these modified reserve levels or direct MPI to dispose of excess retained earnings. Last year, however, the Board advised that MPI should develop a strategy for the disposition of excess funds within these lines of business to the benefit of its ratepayers, and this year the Corporation has advised that it will transfer excess retained earnings from Extension and SRE into the RSR prior the end of 2014/15. The Board applauds the Corporation's decision in this regard, to assist Basic ratepayers and alleviate, at least in part, the shortfall in the Basic RSR. The Board again recommends that the Corporation should develop an ongoing and transparent strategy for the disposition of these excess funds to the benefit of ratepayers. The Board is concerned about improvised or irregular decisions to deal with excess reserves from funds that should be used, as a matter of course, to provide support to Basic insurance, without which the other business lines could not exist.

As the Board has expressed in the past, and most recently in Order 162/11, the Board continues to hold the view that the Extension and SRE lines of business should be regulated, given MPI's market position as a near monopoly provider of non-compulsory auto insurance in Manitoba. The Board again recommends to the Government, therefore, that its jurisdiction be extended to include non-Basic lines of business, including rates and retained earnings.

6.0 RATE DESIGN

6.1 *Actuarial Methodology*

The Application reflects an actuarial methodology for forecasting the required rate levels which is substantially unchanged from that used in last year's application.

6.2 *Vehicle Classification System*

The Corporation continues to classify vehicle risk by considering insurance use, rating territories, and rate groups. Insurance use classifications categorize vehicles by the nature of the vehicle and its intended insurance use. There have been no changes in insurance use classifications in this application.

Vehicles are assigned to one of five territories in Manitoba, including a commuter territory in the areas adjacent to the City of Winnipeg, based on the primary residence of the registered vehicle owner. There have been no changes to the rating territories in this application.

6.3 *Major Classification, Insurance Use and Rating Territory*

The Corporation utilizes the financial forecast method as the basis for proposed rate adjustments. The Corporation develops indicated adjustments by insurance use categories within the Major Classifications and for each territory. To avoid rate shock, the Corporation continues to cap experience adjustments as follows: if the indicated experience adjustment is 10% or less in magnitude, the rate is adjusted by the indicated amount; if the indicated experience adjustment is greater than 10% in magnitude, the rate is adjusted by 10% plus one third of the difference between the indicated adjustment and 10%, up to a maximum of 15%.

6.4 *Canadian Loss Experience Automobile Rating ("CLEAR")*

For passenger vehicles and light trucks, MPI uses a rating system called CLEAR, which amalgamates data from Canadian insurers and creates rate groups (up to 99) by vehicle type for each of collision, comprehensive and accident benefits coverage. MPI combines those rate groups to produce a fewer number of MPI rate groups. MPI applies its own experience by rate groups, thereby re-calibrating the CLEAR data.

6.5 Actuarial Standards of Practice

The Application reflects the same fundamental approach to Basic ratemaking that has been employed by MPI for many years. The objective of the GRA approach is to determine the rate level change that approximates a break-even result. MPI has advised that it seeks to break-even on the basis of average net income over two years (in this Application 2015/16 and 2016/17), due to the staggered renewal of Basic insurance. The Board recognizes that the forecasting of net income is challenging, in particular the forecasting of claims incurred and investment income, both of which are subject to considerable uncertainty, in part due to interest rate sensitivity.

MPI acknowledges that it has not prepared the GRA rate indications in accordance with accepted actuarial practice in Canada, as defined by the Canadian Institute of Actuaries, including the property and casualty insurance ratemaking Standard of Practice. In particular, accepted actuarial practice in Canada requires recognition of the time value of money, and a matching of the estimated present value of revenues and expenses (including profit) for policies to be issued in a future rating period. The issues related to interest rate assumptions for ratemaking in accordance with accepted actuarial practice in Canada are fundamentally different from those for ratemaking as done in the GRA, though there is nothing in the requirements of accepted actuarial practice in Canada which conflicts with the objective of MPI that Basic break even.

6.6 Interveners' Positions

CAC

CAC stated that it is uncertain of the reliability of the Corporation's ultimate claims forecast for PIPP, as well as its collision severity estimates, given both the change in forecast methodology and the unusual claims processing issues faced by MPI in the winter of 2013/14.

CMMG

CMMG stated that MPI's ratemaking is not in compliance with three aspects of the Actuarial Standards of Practice: Standards 1730.11, 2620.05 and 2620.09.

In particular, CMMG stated that MPI failed to comply with Standard 1730.11, which provides that "Other things being the same, pertinent past experience data are data....relating to the recent past rather than to the distant past..." on the basis that MPI utilizes a ten-year history of motorcycle claims experience for rate-setting purposes, which, in effect, penalizes motorcyclists for one or two bad years at the beginning of that ten-year period. CMMG stated that pursuant to Standard 1730.11, MPI should utilize a five-year period for rate-making purposes.

CMMG stated that MPI failed to comply with Standard 2620.05, which provides that an actuary would consider that the subject experience, related experience and future cash flows may be affected by changes in circumstances that may affect expected claim costs, expense costs and provision for profit. CMMG stated that the Corporation has refused to give a greater weighting to the years since the Board ordered changes to the loss distribution rules in Order 122/10.

CMMG stated also that MPI failed to comply with Standard 2620.09, which provides that an actuary should consider that loss experience may have been subject to a catastrophe, a large loss or other unusual events. CMMG stated that MPI has refused to use large loss capping, which would have mitigated rate changes for the motorcycle class.

6.7 Board Findings

The Board encourages the continued development of MPI's rate-making model in accordance with accepted actuarial practice in Canada. The Board notes that the Corporation's GRA rate proposal is based upon Basic's income statement result, as opposed to estimating rate level requirements in accordance with accepted actuarial practice in Canada. The Corporation holds the view that due to the staggered renewals of insurance policies, the Board, for the purposes of rate-setting, should consider whether the Corporation breaks even over a two-year period (the year of the application and the year subsequent), by averaging the net financial result of Basic over those two years on an equal basis. The Board typically considers the net financial result of Basic in the year of the Application only. This is due to the second year being impacted by the subsequent year's GRA, including improved forecasting. The Board directs MPI to file a discussion paper at next year's GRA on this issue, in order that it can be fully canvassed and decided upon.

The Board also orders MPI to provide, at the next GRA, updated rate indications derived in accordance with accepted actuarial practice in Canada, with an accompanying discussion paper addressing the revenue/expense matching principles underlying the two sets of rate indications, i.e., those done in accordance with accepted actuarial practice in Canada vs. those done within an accounting paradigm as used by MPI for many years.

The Board orders that MPI provide improved disclosure in its valuation reports regarding the nature and treatment of anomalies in the data, for example the March 2013 PIPP case reserve review, in order that the Board and all parties can be assisted in reviewing changes implemented by MPI.

With respect to the actuarial Standards of Practice, the Board does not accept the submissions of CMMG relative to the series of alleged failures to comply by MPI. With respect to Standard 1730.11, the Board finds that the use of a longer data set for the analysis of Motorcycle Major Class Accident Benefits (Other and Income Replacement Indemnity) experience was done to smooth out the larger volatility in the data and enhance the statistical credibility of the information. The Board finds that a more responsive, less stable model is not preferable for rate-making. If the motorcycle class has poor experience this year, or next year, the impact of that experience would be more severe upon rates going forward.

With respect to Standard 2620.05, the Board finds that MPI's ratemaking methodology attempts to adjust historical experience to be relevant to the future rating period. For example, the Corporation did give additional consideration in the calculation of the major classes' required rates pursuant to Order 126/10, wherein an earlier Board order, 97/05, was expanded to include single vehicle accidents involving wildlife and livestock.

With respect to Standard 2620.09, the Board notes that the language used by the CIA is suggestive, not mandatory, in that the actuary "would" consider that loss experience may have been subject to a catastrophe, large loss or other unusual event. MPI does utilize large loss capping procedures to replace actual large losses with average large losses for a longer historical period, in the analysis of insurance use and territory, but does not do so at the major class level, presumably to limit cross-subsidization. Instead, and as reflected above, the shift to using a longer data set for the analysis of Accident Benefits experience was done to smooth out the larger volatility in the data.

7.0 ROAD SAFETY

Road safety and loss prevention costs account for less than approximately 1.5% of Basic costs over the forecast period, nearing 1% by 2018/19. In 2013/14, the Corporation's actual road safety and loss prevention expenses were approximately \$12.8 million. Road safety expenses are forecasted to decrease to \$11.3 million in 2014/15, and to \$10.5 million in each of 2015/16 and 2016/17.

The Corporation's Strategic Plan continues to reflect that it has always had an unwavering commitment to reducing roadway risk in a manner that is supported and expected by Manitobans, and that, as Manitoba's auto insurer and as administrator of *The Drivers and Vehicles Act*, there may be opportunities to leverage this dual role to contribute to an even greater extent to road safety efforts in Manitoba.

In 2011, Manitobans were invited to share their views on the Corporation's role in the area of road safety in visioning process, through which MPI received input from approximately 1,100 Manitobans and stakeholders. The Corporation filed with the Board at the 2013 GRA the results of this public consultation report, which included the conclusion that Manitobans want the Corporation to strengthen its role as a strategic leader in the road safety arena, and to work with partners as the single agency to coordinate the efforts of all key players. According to MPI, there was a clear message that it should act as the central repository to facilitate the sharing of data amongst stakeholders for conducting research and making informed decisions, and to take a much more active role in road safety research. Historically, the Corporation has concentrated its efforts on education to change motorists' attitudes in order to reduce claims incurred costs. It has focused on the areas of unsafe speed, impaired driving, seatbelt usage and more recently distracted driving.

Since the visioning process, the Corporation has taken steps to review and revise the High School Driver Education Program, in connection with which it obtained a report from the American Driver and Traffic Safety Education Association. The Corporation also participated in the AAA Foundation for Traffic Safety Report (AAA Study), the results of which were received by the Corporation in September 2014.

The Corporation maintains that Road Safety is complex, that there can be many causes of and interdependencies between motor vehicle collisions and the injuries sustained in those collisions, and that there is no easy solution for preventing injuries sustained in motor vehicle collisions. The Corporation has stated also that the results of road safety initiatives can be difficult to measure, to the extent that a collision that does not occur would not typically come to the attention of the Corporation.

MPI states that there are many stakeholders who have a role in improving Road Safety, including the Corporation as well as the Province of Manitoba, various law enforcement agencies, and others and that there are complex interdependencies in their relationships.

MPI proposes that its road safety initiatives be addressed going forward within the loss prevention funding envelope. Loss prevention efforts by the Corporation include many items that do not include a road safety component, such as auto theft prevention, Driver Safety Rating, Fleet Management Program, fraud recovery, physical damage research and enhanced training for adjusters and estimators.

MPI filed with the Board, upon request, a draft loss prevention and road safety framework and scorecard and requested that the Board provide feedback on the approach proposed by MPI.

MPI also advised that it is in the process of establishing a three-year road safety strategic plan, which will formalize internal processes for analyzing traffic collision and claims data, identify other potential sources of data external to the Corporation that may be useful in establishing priorities, and conducting research of proven and promising road safety programs and initiatives that offer the greatest opportunity to reduce collisions, fatalities, injuries and claims costs. The Corporation has stated that the evaluation framework will include specific and tangible measures with which to assess the effectiveness of road safety activities at the program, portfolio and overall road safety priority level.

7.1 *Intervenors' Positions*

BW

BW advised that it does not agree with the proposed new construct for loss prevention strategy, and that the draft document provided by MPI is unclear.

BW noted the evolution of road safety matters before the Board over the last number of years, as follows:

- in Order 122/10, the Board recommended the establishment of a road safety fund from the RSR, which MPI did not accept because it did not have any specific initiatives in mind on which to expend such a fund;
- in Order 157/12, the Board ordered that MPI assign to road safety a higher priority, and ordered that a research technical conference be convened to discuss matters of road safety with a view to reducing claims costs. MPI disagreed with the research technical conference and asked that the Board vary its order in this regard. The Board did so, in Order 22/13 and ordered that MPI file evidence at the 2014 GRA relative to a variety of road safety matters. MPI did file evidence at the 2014 GRA, but not with respect to all of the matters ordered by the Board; and
- in Order 151/13, the Board ordered that MPI provide an independent review of the optimal size of a road safety budget portfolio for the Corporation with a view to minimizing the social and economic costs of collisions, and MPI has not done so.

BW stated that there is no reason why an independent review of MPI's road safety budget could not have been provided in this filing. BW also stated that the new construct proposed by MPI is not sound, and is not done in any other jurisdiction in Canada. BW stated that road safety should be addressed as a stand-alone issue, and that if road safety is included within a comprehensive loss prevention umbrella, intangible issues relative to road safety may be lost.

BW's concerns stem from the reality that road safety concerns involve more than property damage; there are significant human and social costs and BW questioned how those can be included within the proposed loss prevention construct. BW stated that road safety should not be dependent upon the payback of other loss prevention programs.

BW stated that MPI interprets its mandate relative to road safety as one related to a reduction of claims costs where the business case can be made. BW stated that this factor is not referenced in the legislation and that MPI should add resources and increase its activity in the community now.

BW stated that MPI can and should measure the safety of Manitobans on the roads, and discount variables that are outside its control. BW also suggested that MPI should have goals and targets relative to its road safety efforts that it should be required to meet.

CAC

CAC asked that the Board reiterate the message of Ms. Mavis Johnson of the Canadian Traffic Safety Institute, a Road Safety specialist who testified at the 2014 GRA. Ms. Johnson testified that road safety expenditures should be justified in terms of their cost effectiveness both financially and socially at the program level, the portfolio level and within an integrated road safety approach.

CAC also asked that the Board exercise care in considering the proposed analysis pursuant to which loss prevention and road safety efforts are merged given the risk that social and financially desirable investments may be missed.

CAC asked that the Board direct MPI to provide an update on the cost effectiveness of the High School Driver Education program within a reasonable time period, together with a follow up to the AAA Study.

CMMG

CMMG expressed the view that MPI has failed to address important issues of road safety including distracted driving, wildlife collisions and hot-mapping. CMMG looks forward to reviewing the comprehensive road safety plan to be filed by the Corporation next year.

CAA

CAA supported the loss prevention scorecard advanced by MPI, but stated that matters of road safety should remain as a part of the GRA application, and should be addressed separately from loss prevention.

CAA stated that MPI should take a leadership role in road safety matters, in connection with which it has had discussions with the Minister of Infrastructure and the Minister responsible for MPI, together with BW and CAC.

7.2 Board Findings

In past orders the Board has consistently expressed the view that matters of road safety need to be given a higher priority by the Corporation than has been assigned in the past.

The Board repeats that both road safety and loss prevention are significant issues for the Corporation that affect Basic's revenue requirement in a direct and material way and thus impact rates. As such, it is imperative that the value from those programs be maximized. In addition, successful road safety and loss prevention programs can minimize the economic and social costs to ratepayers resulting from collisions.

The Board orders that:

- the loss prevention and road safety framework proposed by MPI be pursued, in which context the optimal size of the applicable budget must be examined;
- the road safety budget must be maintained as an item distinct from the Corporation's loss prevention budget;
- MPI to provide an update on the cost effectiveness of the High School Driver Education program at the next GRA, together with a follow up to the AAA Study;
- MPI provide at the next GRA an update regarding the Corporation's plans for changes to the High School Driver Education program;
- MPI provide at the next GRA an independent review of the optimal size of a road safety budget portfolio for the Corporation with a view to minimizing the economic and social costs of collisions and
- MPI provide at the next GRA an independent review of the current road safety portfolio with a view to optimizing it (relative to cost effectiveness and to setting goals for outcomes) and minimizing the economic and social costs of collisions.

The Board acknowledges, as it has in the past, that some elements of the Corporation's road safety and loss prevention are more measureable than others in terms of achievable and achieved outcomes including collision reduction and claims cost savings. The Board states, however, that the evidence put before the Board last year by Ms. Mavis Johnson on behalf of CAC reflected that there are alternative means the MPI can pursue to enhance its ability to evaluate road safety programs.

The Board recommends that MPI engage all stakeholders (e.g. enforcement and municipal officials, citizen groups, Bike Winnipeg, etc.) in the development of the loss prevention and road safety framework.

8.0 PREVIOUS BOARD ORDERS

There have been several instances referenced through the GRA process wherein MPI has not completed items that the Board ordered it to complete in last year's Order 151/13. This approach is not acceptable to the Board.

The Board views its role relative to Basic rate-setting as a vitally important one, and its Orders must be complied with, in the absence of a successful request to review and vary, or a successful appeal. The Board takes its jurisdiction relative to MPI very seriously, and notes that if its Orders are not complied with, the issue of whether subsequently proposed rates are just and reasonable may be difficult to determine.

The Board notes that over the course of this year's GRA process there was a procedural step not encountered previously in an MPI GRA; the Corporation refused to answer approximately 40% of the first round information requests posed. A series of motions to compel answers followed, and the issue was resolved pursuant to Order 98/14. This process resulted in additional regulatory costs and made the GRA process less efficient than in prior years.

In addition, there was some uncertainty regarding the level of participation by the Corporation's President and CEO, Mr. Dan Guimond, in terms of attendance at the GRA hearing. As the hearing unfolded, Mr. Guimond elected to attend the entire proceeding, which was very much appreciated by the Board, and the Board looks forward to Mr. Guimond's ongoing attendance at future GRA hearings.

9.0 PRESENTERS

The Board heard from a series of presenters at the hearing of the Application. The presenters are not sworn witnesses and were not cross-examined. As such, although the content of the presentations is not evidence, the Board, MPI and the interveners received the information presented for consideration only. As always, MPI will respond to each presenter in writing, with respect to the presentation made to the Board.

Mr. Robert Gray stated that the advertising costs incurred by MPI, as well as legal fees should be limited given the nature of MPI's business. Mr. Gray also stated that the number of employees of MPI, including sub-contractors, should not be increasing every year, and outpacing increases in revenue. Mr. Gray also commented upon the contract entered into as between the Corporation and its former Chief Executive Officer, Ms. Marilyn McLaren, which was spoken to by the Corporation before the Standing Committee of the Legislature, at which time the Legislature did not accept the annual reports of the Corporation for the years ending 2012 and 2013. Mr. Gray stated that the Corporation should conduct itself in a transparent manner, and expressed concern over the amount of money being retained by the Corporation.

Mr. Doug Houghton, a Director and Past President of the CMMG, spoke on his own behalf and expressed the view that even with a proposed overall rate decrease for the motorcycle class, motorcycle premiums are still cost-prohibitive for many riders, particularly when compared with private passenger vehicle premiums. Mr. Houghton stated that while over the last number of years the motorcycle class has enjoyed overall rate decreases, these decreases have not offset the previous decade of double digit, compounded premium increases.

Mr. Houghton stated that in his view, and in the view of many motorcyclists, the existing loss transfer methodology utilized within the Corporation is unfairly discriminatory, and notes that motorcyclists do not experience as many collisions as some may think. Mr. Houghton noted that some vehicle classes do not contribute to PIPP, including inter-provincial trucks, exempt government vehicles, off-road vehicles, dirt bikes and snowmobiles, as well as bicyclists and pedestrians. Mr. Houghton expressed the view that motorcyclists should not be paying substantially more for PIPP coverage, when many other vehicle owners do not.

Mr. Houghton suggested that a flat rate for PIPP premiums should be implemented, in order that those premiums are spread equally across all vehicle groups, with increases based on experience and driving record, not severity of injuries. Mr. Houghton also suggested that PIPP costs be borne by licensed drivers who do not have a vehicle registered in their name. Mr. Houghton stated that the current systems encourages high risk drivers to transfer ownership of their vehicles to other family members with better driving records, in order that overall, a lesser premium is paid to the Corporation. He further suggested that MPI provide a multi-vehicle discount where one of the vehicles owned by a ratepayer is a motorcycle, as the risks associated with a motorcyclist's private passenger vehicle appear to diminish.

Mr. Houghton recognized that some of the matters to which he spoke involved public policy, and were not within the mandate of the Board, but Mr. Houghton requested that the Board recommend that MPI and/or the Province of Manitoba study the issue of a flat rate for PIPP premiums, and learn how such a system would affect average premiums for all classes.

Mr. Houghton expressed concerns with respect to the ability of claimants to buy back claims, and stated that MPI adjusters should be better informed in estimating the value of customized upgrades in motorcycles. Mr. Houghton suggested that where a motorcycle is written off as unrepairable, the owner should have the option of buying back the motorcycle for an amount equal to the difference between the settlement price and the repair costs.

Mr. John Ewing, member of the Manitoba Classic and Antique Auto Club, expressed concerns with respect to the Collector Vehicle Program implemented by MPI. Mr. Ewing advised that for typical collector car owners, average mileage may be 500 miles per year, given that vehicles are driven only in clear weather. Mr. Ewing stated that at the time that the Collector Vehicle Program was rolled out by the Province, the declaration was made that owners would get a 45% discount from the pleasure use premiums or regular use premiums on vehicles, which sounded favourable. In addition, layup coverage for storage would be allowed. Since implementation of the project, it has come to light that the program coverage is in place from May 1 through September 30, known as the driving season. As a result, Mr. Ewing stated that the Collector Vehicle Program gives rise to premiums that are actually 32% higher than current pleasure use premiums. In addition, layup coverage is not available as promised by the Province. Mr. Ewing stated that uptake on the program has been less than anticipated, as many collector vehicle owners are maintaining regular, pleasure use coverage. Mr. Ewing commented that in the Provinces of Saskatchewan and British Columbia, collector plate premiums are as much as 80% lower than regular vehicles.

Mr. Kent Ledingham presented to the Board on behalf of the Manitoba Motor Dealers Association, together with Mr. Steve Chipman, President and CEO of Birchwood Automotive Group, and Michael Blackey, a representative of the Automotive Trades Association, all of whom participate in a joint working group with MPI. Mr. Ledingham stated that the industry has evolved, and rapid changes are being seen, including autonomous driver options, lightweight materials, and diverse repair procedures. Mr. Ledingham stated that with the introduction of new vehicles including carbon fiber or aluminum bodies, the industry will be challenged to keep up with repairs. It is anticipated the roughly 240 new models or redesigns will be released into the market by 2016. Mr. Ledingham stated that the impact of the new technology will be specific requirements by some original equipment manufacturers in terms of who can perform repairs, and the requirements for replacement parts to maintain vehicle warranty. Mr. Ledingham also stated that original equipment manufacturers have developed parts programs in the past several years, that provide new OEM parts and aftermarket or recycled parts pricing, which has a positive impact on Manitoba's customer satisfaction, and reduces warranty costs. There are new tools, equipment and training procedures required to be implemented in order to address the changing vehicle content that would be coming from the industry. Investments are required in training, tooling and infrastructure to provide safe, quality repairs, as well as re-education of staff. Repair shops will need to invest in training, infrastructure, and equipment to be qualified by the manufacturer, and learn new repair procedures. There will be certain repair facilities introduced by some manufacturers that will limit customer choice in terms of repair location. All repair shops will not be able to do all repairs in the future. The first concern of the industry is always the quality of a proper repair, done by qualified, knowledgeable and skilled staff to handle emerging conditions. These factors will lead to higher repair costs, which will directly impact the corporation.

Both the ATA and MMDA have long standing relationships with the Corporation, and together seek to act in the best interests of rate payers in the industry. Certainly, rate predictability and stability is seen to be in the best interests of all Manitobans. The attraction and retention of qualified trades people has been and continues to be an issue in the industry, as a result of which a tool allowance apprenticeship cost program, funded by the Corporation, has been implemented. Mr. Ledingham stated that the role of the Corporation in training will become increasingly important going forward, as a broader set of skills are required, with less frequent use as new models are introduced. Mr. Ledingham stated that MPI must keep pace with rapidly changing technology and vehicle design to be able to provide guidance to the industry, and must be the experts to ensure the integrity of the industry.

Mr. Ledingham advised that a two year labour rate agreement for motor vehicle repair shops in Manitoba has been concluded with MPI, to take effect on January 1, 2015, through December 31, 2016. The common goals of the industry and MPI are to maintain the health of the industry, maintain costs, and provide exceptional service to shared customers. Mr. Ledingham stated that the first phase of the Physical Damage Reengineering Program, collaborative estimating, brings shops and MPI on to a common technology platform, with shops utilizing the Mitchell Repair Centre, the rollout of which will be completed over the course of approximately one year. Mr. Ledingham advised that the Physical Damage Reengineering Program will also include a distributed estimating proof of concept, where the possibility of having shops write first estimates instead of MPI will be tested. The industry intends to work closely with MPI to develop solutions to common issues in that process.

Mr. Blackey advised the panel that the MMDA and ATA have met with manufacturers, each of which has a different standard of what they're teaching and supplying to the industry in terms of technology required to repair vehicles. Some manufactures have very high standards, while others have none at all, and the industry has been attempting to move towards a program of education and training, for province wide training in order cars can be repaired properly. MPI is involved in this process. Mr. Blackey also stated that if great quality recycled parts were provided every time a recycled part was obtained, those parts would be utilized more often, and he also stated that when a substandard part is provided, the course necessary to resolve the issue is labour intensive for the shop, and in addition, causes delay and annoyance to customers. Mr. Blackey also stated that ARM has not adopted the standards of the National Recyclers Association.

Mr. Steve Chipman advised that aluminum repairs require special equipment, and cannot be repaired in the same room as steel. There must be a different, segregated room for aluminum repairs, which will cost repair shops significant infrastructure to establish, in addition to the costs of training staff to perform the repairs. The shift to aluminum parts is driven by a desire to reduce fuel consumption in vehicles. Mr. Chipman also stated that a significant priority for the industry is to repair customer's cars quickly, and to do so properly, and at a good price. Mr. Chipman also advised that the industry and MPI negotiated strenuously with respect to labour rates, through a long process, to arrive at an agreed rate fair to both sides.

Unicity Taxi and Duffy's Taxi made a joint presentation to the Board, through their counsel, Mr. Marty Minuk. Mr. Minuk advised the Board that the current annual basic insurance premium that each owner/operator pays is \$8,200.00, with a \$600.00 deductible. Unicity and Duffy's state that these premiums are in contrast to the premiums paid by limousine operators, which are approximately \$2,500.00 per year, also with a \$600.00 deductible. Unicity and Duffy's have noted that the proposed rate increase for the public class is in the range of 5.3 or 5.4%, which equates to approximately between \$36.22 and \$36.90 per month, such that overall premiums for most taxis would increase to approximately \$8,642.80 per year.

Mr. Minuk explained that both Unicity and Duffy's operate through individual owner/operators, and that each company serves as a dispatch company for its shareholders. Mr. Minuk stated that while the evidence of MPI was that taxicabs had opted out of the fleet rebate program, in reality, the vehicles are ineligible, because there is no common ownership of vehicles, and the fleet program requires 10 or more vehicles registered by the same owner. Mr. Minuk advised that Unicity and Duffy's wish to work with MPI to determine whether some benefit can be extended in a way of a fleet program, given that the structure of ownership within the companies apparently prohibits formal participation in the fleet rebate program.

Mr. Minuk stated also that in the future, Unicity and Duffy's may seek intervener status in the MPI GRA, due to the significant rate increases requested for taxicabs which do not appear to be justified.

Mr. Stephen Fletcher, Managing Director of the Automotive Recyclers of Canada (ARC) made a presentation on behalf of ARM and provided context to the role of ARM and auto recycling in general. ARC is a nonprofit organization and represents professional auto recyclers across Canada, including ARM. Mr. Fletcher provided a description of ARC's governance model as its national and international activities.

Mr. Fletcher also provided a detailed description of the auto-recycling processing of end-of-life vehicles, including that recyclers use the vehicle information number (VIN) to determine the inherent value that a vehicle has in terms of parts, materials, and the various components that can be removed. Auto recycling is a very data intensive business, and is sophisticated in terms of the ability to manage parts information.

Mr. Fletcher stated that ARC is acutely aware that the vehicles are changing and becoming more complex, noting that auto recyclers are working with automobile manufacturers such as General Motors to determine how best to recycle hybrid batteries in newer, more complex vehicles. Mr. Fletcher spoke to the importance of auto recyclers' roles in the environment in the recycling of vehicles, describing how ARC worked with Environment Canada on the "Retire Your Ride" program, a strategy to retire less energy-efficient vehicles to reduce emissions. Through this program, ARC was commissioned by Environment Canada to establish a compliance best practice manual for auto recyclers to participate in the program, which resulted in the Canada Auto Recyclers Environmental Code.

Mr. Fletcher stated that auto recycling is a sophisticated industry and that ARM is an interconnected entity and does not exist in isolation in Manitoba. ARC recognizes that recycling is a small industry in the automotive sector and must collaborate with others. Mr. Fletcher stated that a lot of the activity that ARM has had with MPI has revolved around parts in the Recyclers' Central Office (RCO).

A major issue across Canada is effective access to vehicles, whether premature or end-of-life vehicles. There are opportunities to talk to MPI about access to vehicle total losses that are generated through MPI, noting that a recycler does not have inventory to sell parts if they do not have access to vehicles.

Mr. Fletcher stated that much of the discussion at the hearing had been around the economic sustainability of the industry and that ARM is available to collaborate and share information with MPI. ARM is seeking a two way interaction and dialogue.

Mr. Fletcher acknowledged that change is inevitable but stated that auto recyclers in Manitoba will react to change be it in information or technology issues. ARM is looking forward to returning to a business partnership with MPI and believes that having a healthy auto recycling sector is good for Manitoba, not only in terms of rate stabilization. ARM is not advocating for minimum recycling content and does not believe in market intervention at that level. Mr. Fletcher stated that ARC and ARM believe in transparency in dialogue to ensure that all parties can be successful. ARM has a massive role to play in making sure that savings are available now and in the long term for MPI and for the motoring public.

In addition, there were a number of individuals that made written submissions to the Board, but did not attend the hearing. Each of those written presentations was circulated among all parties, including interveners, and was filed with the Board. In particular, the Board received correspondence from each of Werner E. Hohler, Bev McIntyre, Karl Carnegie, Claude Gagne, Todd Baraniuk and Glen Urb advising that, among other things, no rate increase should be approved.

10.0 IT IS THEREFORE RECOMMENDED THAT:

- 10.1 The Province of Manitoba extend the Board's jurisdiction to include non-Basic lines of business, including with respect to rates and retained earnings.
- 10.2 In the absence of Board jurisdiction over non-Basic lines of business, the Corporation should develop a transparent strategy for the disposition of excess retained earnings in the Extension and SRE lines of business, to the benefit of Basic ratepayers.
- 10.3 Relative to auto recycling:
 - a "recycle first" policy be maintained in any future arrangements between auto recyclers and MPI;
 - MPI adopt a strong initiative to both foster and assist the auto recycling industry to assist it to remain viable and sustainable;
 - the development of the PDR Project be done by MPI in a co-operative and considered manner, which involves ARM, including the automation of the parts processing and repair estimates; and
 - MPI meet its pledge relative to the RCO, and work with ARM and other recyclers to revisit operation of the RCO to ensure transparency and efficiency.

11.0 IT IS THEREFORE ORDERED THAT:

- 11.1 There shall be an overall 3.4% rate increase in compulsory Motor Vehicle Premiums for 2015/16 insurance year, effective March 1, 2015 for all major classes combined, which rate increase **BE AND HEREBY IS APPROVED.**
- 11.2 MPI's requests that there be no change in Permit and Certificate rates, Vehicle Premium Discounts and Driver License Premiums, Service and Transaction Fees, Fleet Rebates or Surcharges, or the discount on approved after-market and manufacturer/dealer installed anti-theft devices **BE AND HEREBY ARE APPROVED.**
- 11.3 MPI file an update at next year's GRA with respect to all initiatives that may have IT cost implications for Basic, including the five-year IT strategic plan and cost-benefit analysis as directed in Order 151/13, together with any reports generated relative to MPI's IT vision and strategy development exercises.
- 11.4 With respect to the PDR Project, MPI file with the Board at next year's GRA:
- a) the terms of reference and the outcome of the pilot project on "management by exception" collision estimating;
 - b) an updated estimate of the projected costs and benefits associated with the PDR Project including empirical information assessing the success of management by exception in terms of collision estimating as compared to other collision claims control options;
 - c) an update on how barriers (including training) to cost effective estimating and collision repair are being addressed; and
 - d) baselines in terms of duration of repair shop contact with MPI and preliminary metrics by which to assess cost containment achievements of the PDR Project.

- 11.5 MPI provide, at next year's GRA, an update on the claim duration issue including whether pre-BI³ benchmarks are being achieved and when post-BI³ benchmarks will be implemented and what those benchmarks will be.
- 11.6 MPI undertake an external, independent review of the management and oversight of PIPP claims in the context of post-BI³ implementation, to learn whether the initiative is providing the desired impact, and file the result of the review at next year's GRA.
- 11.7 MPI file at next year's GRA updated results relative to Serving Manitobans and Community Impact benchmarking.
- 11.8 MPI file the ALM Study with the Board at next year's GRA together with its proposed course of action and the steps that MPI has already taken to substantially mitigate interest rate risk.
- 11.9 MPI prepare and file, at next year's GRA, a discussion paper relative to the stated purpose of the RSR, whether that purpose is met pursuant to the manner in which MPI utilizes the RSR and relative to the accounting for the RSR.
- 11.10 MPI respond to the document attached at Appendix E hereto, in writing, promptly, with a copy to all interveners and engage in an ongoing dialogue among all parties relative to Phase I, and subsequently Phase II as referenced in Appendix E, such that Phase II is completed prior to the preparation of MPI's 2015 DCAT report.
- 11.11 MPI to consult with all parties and file with the Board a proposed schedule pursuant to which the steps of the process referenced at paragraph 11.10 above will be completed.
- 11.12 MPI file in next year's GRA Basic MCT calculations for all years for all scenarios within the annual DCAT report.

- 11.13 MPI file a discussion paper at next year's GRA relative to whether Basic's break-even position should be assessed over a one year or two year period.
- 11.14 MPI provide, at next year's GRA, updated rate indications derived in accordance with accepted actuarial practice in Canada, with an accompanying discussion paper addressing the revenue/expense matching principles underlying the two sets of rate indications.
- 11.15 MPI provide improved disclosure in its valuation reports regarding the nature and treatment of anomalies in the data.
- 11.16 The loss prevention and road safety framework proposed by MPI be pursued, in which context the optimal size of the applicable budget must be examined and that Basic's road safety budget must be maintained as an item distinct from its loss prevention budget.
- 11.17 MPI provide an update on the cost effectiveness of the High School Driver Education program at next year's GRA, together with a follow up to the 2014 AAA Study.
- 11.18 MPI provide at next year's GRA an update regarding its plans for changes to the High School Driver Education program.
- 11.19 MPI provide at next year's GRA an independent review of the optimal size of a road safety budget portfolio for the Corporation with a view to minimizing the economic and social costs of collisions.
- 11.20 MPI provide at next year's GRA an independent review of the current road safety portfolio with a view to optimizing it (relative to cost effectiveness and to setting goals for outcomes) and minimizing the economic and social costs of collisions.

Board decisions may be appealed in accordance with the provisions of section 58 of *The Public Utilities Board Act*. The procedural rules applicable to the Board's review of its decisions are reflected in the Board's Rules of Practice and Procedure, which may be viewed on the Board's website, www.pub.gov.mb.ca.

THE PUBLIC UTILITIES BOARD

"Karen Botting, B.A., B.Ed., M.Ed., Member"
Acting Chair

"Jennifer Dubois, C.M.A."
Acting Secretary

Certified a true copy of Order No. 135/14
issued by The Public Utilities Board

Acting Secretary

Appendix A

Glossary of Acronyms and Terms

| | |
|-------------------------|--|
| Application | 2015 General Rate Application |
| AOCI | Accumulated Other Comprehensive Income |
| ARM | Automotive Recyclers of Manitoba |
| Basic | Compulsory motor vehicle insurance |
| BI ³ Project | Bodily Injury Improvement Initiative |
| Board | Public Utilities Board |
| BW | Bike Winnipeg |
| CAA | Canadian Automobile Association |
| CAC | Consumers' Association of Canada |
| CLEAR | Canadian Loss Experience Automobile Rating |
| CMMG | Coalition of Manitoba Motorcycle Groups |
| Corporation | Manitoba Public Insurance Corporation |
| DCAT | Dynamic Capital Adequacy Testing |
| DSR | Driver Safety Rating |
| Extension | Optional motor vehicle insurance |
| FTE | Full-Time Equivalent |
| Government | Government of Manitoba |
| GRA | General Rate Application |
| IBAM | Insurance Brokers Association of Manitoba |
| ICWG | Investment Committee Working Group (MPI) |
| MGEU | Manitoba Government Employees' Union |
| MPI | Manitoba Public Insurance Corporation |
| No-fault | Accident benefits not related to the fault of the driver |
| OEM | Original Equipment Manufacturers |
| PDR Project | Physical Damage Re-engineering Project |
| PIPP | Personal Injury Protection Plan |
| Province | Government of Manitoba |
| RCO | Recyclers' Central Office |
| RSR | Rate Stabilization Reserve |
| SRE | Optional Special Risk Extension motor vehicle insurance |

Appendix B

Appearances

| | |
|--------------------------|--|
| C. Grammond | Counsel for the Public Utilities Board (“the Board”) |
| K. L. Kalinowsky | Counsel for Manitoba Public Insurance Corporation (MPI or the Corporation) |
| B. Williams / M. Menzies | Counsel for the Consumers’ Association of Canada (Manitoba) Inc. (CAC) |
| R. P. Oakes | Counsel for the Coalition of Manitoba Motorcycle Groups (CMMG) |
| A. Young | Canadian Automobile Association (Manitoba Division) (CAA) |
| D. Schioler | Insurance Brokers Association of Manitoba (IBAM) |
| I. Frost | Automotive Recyclers of Manitoba (ARM) |
| C. Monnin | Bike Winnipeg (BW) |

Appendix C

Witnesses

Witnesses for the Corporation

| | |
|-------------|---|
| D. Guimond | President and Chief Executive Officer |
| L. Johnston | Chief Actuary and Director of Pricing and Economics |
| H. Reichert | Vice-President Finance and Chief Financial Officer |

Witness for CAC

| | |
|------------|------------------------|
| W. Simpson | Professor of Economics |
|------------|------------------------|

Witness for IBAM

| | |
|-------------|--|
| D. Schioler | Insurance Brokers' Association of Manitoba |
|-------------|--|

Appendix D

Interveners

Canadian Automobile Association (CAA)

Coalition of Manitoba Motorcycle Groups Inc. (CMMG)

Consumers' Association of Canada (Manitoba) Inc. (CAC)

Insurance Brokers Association of Manitoba (IBAM)

Automotive Recyclers of Manitoba (ARM)

Bike Winnipeg (BW)

In-person Presenters

| | |
|--------------|--|
| M. Blackey | Automotive Trades Association |
| S. Chipman | Birchwood Automotive Group |
| J. Ewing | Manitoba Classic and Antique Auto Club |
| S. Fletcher | Automotive Recyclers of Canada |
| R. Gray | Private Citizen |
| D. Houghton | Private Citizen |
| K. Ledingham | Manitoba Motor Dealers' Association |
| M. Minuk | Unicity Taxi and Duffy's Taxi |

Appendix E

Basic RSR/Capital Target Setting Undertaking Request (with context)

Phase 1 - DCAT Adverse Scenarios Before Management/Regulatory Actions

This undertaking request anticipates the results of the requested work being provided in two phases, with the scope of work on Phase 2 being affected by the results of Phase 1.

- ◆ For all modeled scenarios (base or adverse), please include in the summary of scenario results the modeled MCT ratio based on OSFI's 2015 MCT Guideline, if not now, then in the near future.

[Context: The PUB recognizes that MPI is not subject to OSFI's regulatory jurisdiction and that MPI has proposed use of OSFI's MCT of its own accord. MPI has also indicated its intent to "update the MCT calculation based on the latest MCT Guideline" (PUB (MPI) 1-122). For the companies under its jurisdiction, OSFI expects them to phase-in the capital impact of the revised MCT framework on a straight-line basis, over twelve quarters, starting with the first quarter ending in 2015. This phase-in process also requires computation of an MCT ratio under the new framework as at 31 December 2014 (or 31 October 2014). By extension, it would be expected that MPI would first calculate a Basic MCT ratio under the new framework as at 28 February 2015, and that such MCT ratios at subsequent quarter ends would reflect OSFI's phase-in. The current GRA proposes use of a 100% MCT ratio as an upper limit to the target range for Total Equity. The PUB's consideration of this proposal may benefit from an improved understanding of the impact of the new framework on Basic's MCT ratio, and the reasonableness of the level of protection against rate instability represented by this level of MCT ratio.]

- ◆ For all adverse scenarios involving fitting of a probability distribution, please provide statistical and graphical evidence of the goodness of fit, both overall and with a particular focus in the adverse tail of the distribution, at least out to the 99.5th percentile.

[Context: Typically, and logically, most of the historical experience used for purposes of fitting a probability distribution is not in the tails of that distribution, whereas it is the tails of the distribution, in particular the upper tail, that is of primary importance to the process of setting appropriate Basic capital targets. Care is needed when using distribution fitting software to ensure that a fitted distribution which presents a good fit overall also performs well in the tail of the distribution.]

- ◆ For all adverse scenarios tested, please augment what is already shown for scenario results (before management/regulatory actions) to include results at a 1-in-200-year (99.5th percentile) level.

[Context: Consideration of modeled scenario outcomes at more remote percentile levels may provide helpful context for the PUB's consideration of an appropriate upper limit to the target range for Basic RSR or Total Equity.]

- ◆ **Loss Ratio Scenario.** For each coverage, and for all coverages combined, please extend the tables shown to include the 99th percentile and 99.5th percentile simulation results.

[Context: See immediately above.]

- ◆ **Equity Decline Scenario.** Please change the modeling approach to include an historically-based post-decline recovery effect, based on a shortened history of the S&P Composite Total Return Index comparable to that currently used in the DCAT.

[Context: MPI's current approach to modeling this scenario involves consideration of "return periods" of 1 to 4 years, during which the modeled adverse equity investment returns are uniformly depressed, with no consideration being given to modeled results beyond the "return period". From examination of the historical TSX total return data, it would appear that multi-year tail events for equity investment returns are more typically the result of a sharp decline, followed by a recovery and then a gradual return to more normal results. The proposed modeling approach here addresses this directly, and in effect negates the need for consideration of "return periods".]

- ◆ **Interest Rate Decline Scenario.** Please change the modeling approach from using percentage point differences (e.g., 5.70% - 4.60% = +1.10 percentage points) to using percentage differences (e.g., 5.70%/4.60% - 1 = +23.91%), based on a shortened history of Government of Canada 10-year bond rates to exclude the "stagflation period".

[Context: From examination of the history of yields on Government of Canada ten-year bonds, it is evident that the magnitude of the percentage point change in these yields over a period is correlated with the magnitude of the starting yield (i.e., in theory bigger percentage point swings are expected at higher yield levels). The proposed modeling approach here is an attempt to address this concern. If it can be demonstrated that inclusion of the "stagflation period" does not distort the selection of adverse assumptions on this basis, then the exclusion of this period may be reconsidered. In addition, if multi-year tail events for interest rate declines modeled on this basis are found to typically behave differently than the current modeling approach of assuming equal annual declines in yield (subject to a minimum yield) during the "return period", a similar approach to that proposed for equity investment declines may be considered appropriate (i.e., modeling the typical behaviour), again potentially negating the need for consideration of "return periods".]

Inflation Scenario. Please change the modeling approach to include up front recognition of the full estimated impact of inflation on future claim and expense payments, and to include consideration of any correlation between inflation and interest rate movements, based on a shortened history of Canadian inflation and Government of Canada 10-year bond rates to exclude the “stagflation period”.

[Context: While up front accounting recognition of the modeled inflationary effects is unlikely to be possible in reality (because the duration of the period of elevated inflation will not be known in advance), doing so may provide useful insight into the stress actually being applied to capital levels at the time the inflationary period begins. The proposed modeling approach here could be provided as an additional alternate Inflation Scenario to that already provided.]

- ◆ **Misestimation Scenario.** Considering the magnitude of historical Basic reserve runoff levels, and considering this risk category is ranked #1 by Saskatchewan Auto Fund, further exploration of this risk category is indicated, if not now, then in the near future. One possibility would be to more deeply investigate the use of reserve variability modeling tools. [Context: The PUB recognizes that this initiative may require significant effort for MPI. The power of the reserve variability modeling tools now available will not only provide improved insight into the inherent risk being modeled for this adverse scenario, but will also provide valuable context around the inherent uncertainty of financial statement unpaid claim provisions.]
- ◆ **Combined Scenario.** Please change the modeling approach to reflect the changes requested for the Equity Decline and the Interest Rate Decline scenarios. In addition, it has been noted that some results currently provided for the Combined Scenario (before management/regulatory actions) are counter-intuitive (e.g., the Total Equity impact of the 2-year Combined Scenario is greater at the 97.5th percentile than at the 99th percentile). Please provide an explanation for such counter-intuitive results, and please confirm that the described step taken to “*order the scenarios from most unfavourable to most favourable*” works with the two sets of simulation results (claims vs. equity/interest rates) in a pairwise manner. Also, please provide some demonstration of the stability of the Combined Scenario modeling results. [Context: It is preferable that the mechanics applied to order scenario results by degree of adversity be done in a way that produces reasonable relationships between scenarios at different percentile levels in the estimated probability distribution of possible scenario outcomes. To the extent the current mechanics applied in this regard fail to achieve this reasonableness test, a demonstration of the stability of the Combined Scenario results may provide helpful context for the PUB’s consideration of the DCAT.]

- ◆ **Alternate Combined Scenario.** Please provide the results of an alternate combined scenario (reflecting the modeling approach changes requested for the Equity Decline and the Interest Rate Decline scenarios) to illustrate the impact of the mitigation of interest rate risk that might be expected from the adoption of cash flow matching of the actuarial liabilities and the underlying investment assets.

[Context: Interest rate risk has clearly been identified by MPI as a significant risk to Basic capital levels. In its evidence, MPI has indicated that this risk can be mitigated through adoption of cash flow matching of the actuarial liabilities and the underlying investment assets (Transcript Page 1111). An improved understanding of the sensitivity of indicated capital target levels to this possible risk mitigation strategy may provide helpful context for the PUB's consideration of Basic capital target levels and the extent of the current need for RSR replenishment]

- ◆ Please provide MPI's recommendations with respect to the following four criteria to be used in the process of selecting worst case adverse scenarios for purposes of applying management/regulatory actions in the estimation of capital target levels:

- 1) Whether the capital target is to be based on RSR level or Total Equity level.
- 2) An adverse scenario probability level appropriate for a capital target range lower limit.
- 3) An adverse scenario probability level appropriate for a capital target range upper limit.

[Context: MPI's proposal of a 100% MCT ratio as an upper limit to the target range for Basic Total Equity does not by itself provide context for what level of protection against rate instability this represents. Consideration of modeled scenario outcomes at more remote percentile levels may provide helpful context for the PUB's consideration of an appropriate upper limit to the target range for Basic RSR or Total Equity.]

- 4) The time horizon over which it is reasonable to require adverse scenario capital levels at or above \$0 for capital target level setting purposes.

[Context: The time horizon referenced here defines the period over which the test conditions used for capital target level setting purposes are applied. OSFI has raised the concept of time horizon as a consideration in the setting of internal capital targets for the companies under its jurisdiction (which MPI clearly is not). OSFI suggested use of a time horizon of at least one year in the June 2011 version of its Guideline A-4 (Regulatory Capital and Internal Capital Targets), as a result of which many insurers under OSFI's supervision adopted a one year time horizon for purposes of setting an internal capital target level. For many risk categories, the longer the time horizon adopted, the more conservative is the resulting internal capital target level.]

Phase 2 - DCAT Adverse Scenarios After Management/Regulatory Actions, and Modified Capital Target Range Scenarios

It is anticipated that the PUB will select criteria (as described in Phase 1) for use in the estimation of capital target levels, based on consideration of MPI's evidence in support of its recommended criteria as initially provided and in response to cross examination by the PUB and interveners.

- ◆ To achieve greater consistency across all adverse scenarios to be subject to management/regulatory actions, please derive the magnitude of the management/regulatory actions dynamically from the results of each adverse scenario before management/regulatory actions. Please also include a description of the logic for this dynamic derivation process.

[Context: MPI uses adverse scenarios after management/regulatory actions for purposes of setting its proposed Basic capital target levels. Currently those management/regulatory actions are selected judgmentally in response to the modeled adverse circumstances before those actions. The nature of this judgmental process may impede one's ability to assess how consistently these management/regulatory actions are selected from one adverse scenario to the next. In the context of a modeling exercise, if the management/regulatory actions could be modeled to dynamically respond to the adverse circumstances following judgmentally selected and reasonable set rules, this proposed approach may improve comparability between modeled adverse scenarios.]

- ◆ For the selected worst case adverse scenario for each of the upper and lower limit probability level criterion for each risk category based on MPI's recommended criteria (from Phase 1), please provide the results of applying the dynamically derived management/regulatory actions.
- ◆ For the selected worst case adverse scenario for each of the upper and lower limit probability level criterion for each risk category based on the PUB's selected criteria (if different), please provide the results of applying the dynamically derived management/regulatory actions.

[Context: It is hoped that the PUB will be in a position of being able to select these criteria following consideration of the results of Phase 1.]

- ◆ For the overall worst case adverse scenario (across all risk categories) for each of the upper and lower limit probability level criterion based on MPI's recommended criteria (from Phase 1):
 - 1) Create a modified lower limit base scenario under which the capital level as at 28 February 2014 is inflated to the estimated lower limit target capital level (with the new assets spread proportionately across the Basic investment portfolio).

[Context: The Basic capital target levels being proposed by MPI are deemed to be as at 28 February 2014 since this is the fiscal year end on which the DCAT investigation is based. The proposed modeling approach here accounts for the accounting consequences of having Basic capital at the target level when assessing the impact of the adverse scenarios being modeled.]
 - 2) Create a modified worst case lower limit adverse scenario by applying the worst case lower limit adverse scenario assumptions to the modified lower limit base scenario.
 - 3) Repeat steps 1 to 3 iteratively, adjusting the estimated lower limit target capital level until the forecasted capital level under the modified worst case lower limit adverse scenario approximates \$0 at the originally chosen low point within the time horizon criterion.
 - 4) Summarize the results of the final modified lower limit base scenario and modified worst case lower limit adverse scenario.
 - 5) Repeat steps 1 to 4 for the estimated upper limit target capital level.
- ◆ Repeat the previous iterative process for the overall worst case adverse scenario (across all risk categories) for each of the upper and lower limit probability level criterion based on the PUB's selected criteria (if different).