

# **“Own what you did” - Regulatory Revisionism and the 2018/19 General Rate Application**

**CLOSING ARGUMENT OF THE PUBLIC INTEREST LAW  
CENTRE ON BEHALF OF THE CONSUMERS’  
ASSOCIATION OF CANADA (MANITOBA BRANCH)**

**2018/19 MPI GRA**

**October 19, 2017**

# **“Own what you did” - a small town saying**

**“You can learn a lot from your mistakes when you aren't busy ignoring them”**

**Does the regulatory narrative presented by MPI accord with the record as captured in prior PUB decisions or the evidence of this hearing?**

**Or**

**Would a more dispassionate review of the regulatory record suggest that the challenges faced by MPI today are the enduring legacy of self-inflicted wounds and yet to be realized opportunities?**

# **“Own what you did” - goes beyond accountability**

Important ramifications for the ultimate rate decision including:

- determinations of the prudence and reasonableness of the Crown Monopoly's actions
- our judgment of the overall health of the Corporation
- our understanding of risks faced by the Corporation

# CAC Manitoba – Evidence Based – Consumer Focused

Over two decades of rate hearings

Core Consumer Rights:

- to be informed
- to choose (or be involved in the regulatory process as a proxy for choice)
- to have a voice in marketplace decision-making
- to consumer education

CAC Manitoba Board guided by evidence and direct consumer contact including focus groups



**CONSUMERS' ASSOCIATION OF CANADA**  
Association des consommateurs du Canada

# The Test

## MPI Onus

*The burden of proof to show that any such increases, changes, or alterations are just and reasonable is upon the owner seeking to make the increases, changes, or alterations*

Public Utilities Board Act, s 84(2)

## Just and reasonable rates

- *Public Utilities Board Act, s 77*
- *Crown Corporations Governance and Accountability Act, s 25(4)*
- *Public Utilities Board Order 98/14, p 28*

# Setting Just and Reasonable Rates

- Ensuring that forecasts are reasonably reliable
- Ensuring that actual and projected costs incurred are necessary and prudent (justified)
- Assessing the reasonable revenue needs of an applicant in the context of its overall general health (including necessary reserves, if any)
- Determining an appropriate allocation of costs between classes (and between drivers and vehicle owners)
- Setting just and reasonable rates in accordance with statutory objectives

# A Proxy for the Marketplace

Legislated monopoly on basic and “de facto” monopoly on extension

There is no marketplace to discipline the activities of Manitoba  
Public Insurance

Consumers rely on the Public Utilities Board and its evidence based  
processes to provide regulatory guidance

Order and its rate decision signalled:

opportunities to bring significant value to the Corporation  
and its ratepayers in ways which better balance the public  
interest



# A Chance for a Fresh Start

**“Own what you did” - particularly important in this hearing**

**MPI has the rare opportunity for a fresh start:**

- **A new board**
- **A new Chief Financial Officer**
- **A new CEO pending**



# Regulatory Dialogue not Ultimatums

Opportunity for this regulator within the context of just and reasonable rates to dialogue with the Crown Monopoly's new leadership

Not through ultimatums but through a candid discussion of how we got to where we are

The best gift this Board could offer to Manitoba ratepayers and to the new Board, CEO and CFO of MPI

# **Outline of Submissions – Part I - The MPI narrative (as CAC MB understands it)**

# Outline of Submissions - Part II - Self-Inflicted Wounds and Unrealized Opportunities

## Self-Inflicted Wounds

- Asset Liability Mismatch Risk and Interest Rate Pricing Risk
- Investment Risk
- Information Technology Business Process Management
- Personal Injury Protection Plan reserving and management risk

## Unrealized Opportunities

- Loss Prevention including more robust models

# Outline of Submissions - Part III - Overall Health of the Corporation

Purpose of the RSR

Defining rate shock

Is there consensus on “the correct way to assess the risk of a significant drawdown”?

Implications of Monopoly Status of MPI and the Relationship between basic and extension

Perspective on the relevance of the MCT

Tweaking the DCAT analysis

# Outline of Submissions - Part IV - Reasonably Reliable Forecasts

Challenges related to Interest Rate Forecasts

Opportunities to Improve the Reliability of estimates of PIPP  
Ultimates

Rate indications consistent with accepted actuarial and  
regulatory practice

# Outline of Submissions - Part V – Summary of Recommendations

# Part I – Key elements of the Implicit MPI Narrative

The losses experienced by MPI over 4 of the last 5 years are through no fault of its own

MPI has left no stone un-turned in seeking efficiency or in mitigating the proposed rate increase

For the purposes of mitigating rate shock, MPI is under capitalized

The proposed changes to Driver Safety Rating are a fair response reflective of the statistical evidence



## **Part II - Self-Inflicted Wounds and Unrealized Opportunities**

# Self-Inflicted Wounds Relating to Asset Liability Mismatch Risk and Interest Rate Pricing Risk

## Key Recommended Findings

- Contrary to regulatory warnings in 2013 and 2014, MPI exposed itself to undue asset/liability mismatch risk by seeking to opportunistically cash in on a duration mismatch between assets and liabilities (which would have benefited MPI if interest rates rose)
- Implications of the asset/liability mismatch continued to be felt during the 2015/16 year
- Despite guidance by the PUB dating back to 2013, 2014, and 2015, MPI exposed itself to undue interest rate pricing risk by setting its rate indicator based on the fiscal year rather than the policy year) contrary to accepted actuarial practice (prior to the 2017/18 rating year)

# Key tools for mitigating risk

One of the tools MPI employs to mitigate interest rate risk is matching duration liabilities and assets on a corporate basis

Yien 1020 and PUB 1-43

Moving to accepted actuarial practice for the rate indication significantly reduces the pricing risk from interest rates because the pricing of the current policies is now just focused on that policy year rather than the entire balance of the claims liabilities

Johnston, 1027, 1029 and 304, see lines 11 -13

# Key tools for mitigating risk (continued)

Moving to accepted actuarial practice (continued)

- it shortens the duration of the forecast period from three years to only to the end of the policy year

Johnston, 1028

- a lot of the interest rate risk is created by the claims liabilities (long-duration and interest rate sensitive) which by definition are not related to the new policy year

Johnston, 1028

Dating back to at least 2013 the PUB was offering guidance to move to these key tools

# The PUB warned of the risk of speculating on asset/liabilities mismatches

2013

the Board notes that MPI is holding excess cash due in anticipation hope that interest rates will increase, such that MPI will recover additional funds to offset some of the losses that it incurred when interest rates dropped. In the view of the Board, it is not appropriate for MPI to speculate on increasing interest rates, thereby risking ratepayers' funds. Rather, it should seek to immunize itself to the extent possible from the impact of changing interest rate

CAC Exhibit 13, Order 151/13, Page 32 of 62 (emphasis added)

# The PUB warned of the risk of speculating on asset/liabilities mismatches (continued)

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.

CAC Exhibit 13, Order 151/13, Page 32 of 62 (emphasis added), See also Johnston, 1024-1025

# MPI continued to bet that Interest Rates would go up

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.

Board Order 135/14 - page 42



# The PUB continued to warn of the risk of speculating on asset/liabilities mismatches

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)

Board Order 135/14, Page 38

# The PUB continued to warn of the risk of speculating on asset/liabilities mismatches (continued)

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.

Board Order 135/14, Page 39 (emphasis added), See also Johnston, 1025-1026

# The PUB continued to warn of the risk of speculating on asset/liabilities mismatches (continued)

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".

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.

From Board Order 135/14, p. 43-44 (emphasis added)

# The Board has consistently maintained that management of interest rate risk is the key

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.

From Board Order 135/14, p. 43-44<sub>26</sub>

# Ongoing Concerns Expressed by PUB and Intervenors in 2015

MPI file with next year's GRA a report regarding its current asset mix, duration matching strategy and strategy to manage Basic interest rate risk, including an update on the status of the use of corporate bonds in the bond portfolio including insight on the performance of those bonds

Board Order 128/15, 75, see also Johnston, 1026

CAC noted that there has been a challenge with the Corporation's interest rate forecasting for many years.

# Ongoing Concerns Expressed by PUB and Intervenors in 2015 (continued)

CAC questioned whether the Corporation's interest rate forecasting methodology should be revisited and whether there is now sufficient immunization for the Corporation's investment portfolio. In particular, Basic suffered losses of \$30.8 million in 2011/12 and \$38.1 million in 2014/15 due to the negative impact of interest rates when the marketable bond yield fell by 0.33% and 0.53% respectively.

Board Order 128/15 - page 46

# **The PUB sought to guide MPI towards following accepted actuarial practice in determining rate indications for a number of years**

## **Board Order 151/13:**

**Page 56: 11.17 MPI file next year's GRA to include rate indications determined in accordance with accepted actuarial practice in Canada, as defined by the Canadian Institute of Actuaries, including applicable Standards of Practice, and that MPI also provide to the Board rate indications pursuant to its current methodology for review.**



# **The PUB sought to guide MPI towards following accepted actuarial practice in determining rate indications for a number of years (continued)**

## **Board Order 135/14:**

Page 58: The Board encourages the continued development of MPI's rate-making model in accordance with accepted actuarial practice in Canada.

Page 59: 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 PUB sought to guide MPI towards following accepted actuarial practice in determining rate indications for a number of years (continued)

## Board Order 128/15:

Page 6: The Board encourages the continued development of MPI's rate-making model in accordance with accepted actuarial practice in Canada. The Board intends to explore this issue further at next year's GRA.

Page 63: The Board encourages the continued development of MPI's rate-making model to be in accordance with accepted actuarial practice in Canada.

Page 77: Board Order 10.21 MPI work collaboratively with the Board's actuarial advisor and the advisors of interveners (as determined by the interveners) to enhance the transparency and robustness of the analysis toward the continued development of MPI's rate-making model to be in accordance with accepted actuarial practice in Canada.

# Care must be taken in considering any assertion by MPI that it suffered interest rate impacts through no fault of its own

Interest Rates: From FY 2014/15 through FY 2016/17, the forecasted interest rates from the major banks did not materialize and resulted in deficient premiums of approximately \$163 million over these two fiscal years.

Exhibit MPI - 37

The risks as well as the tools available to mitigate the most significant consequences of interest rate risk were identified by the PUB in 2013 and 2014

# Investment Risk – Recommended Findings

There are grounds to be concerned that the Corporation accepts undue risk for insufficient benefit

There are grounds to be concerned that the equities portfolio is unduly concentrated

There are grounds to believe that there may be opportunities to reduce portfolio risk through diversification while maintaining or improving return

There are substantive grounds to closely supervise the Corporation's approach to Asset/Liability Matching Analysis including concerns that the current portfolio is **over** concentrated, over-constrained and unduly focused on short term results at risk of long term interests of ratepayers

There are grounds to be concerned that Corporation's approach to both the Asset Liability Study and the Corporate bond purchase was to act in leisure and to repent in haste

# Relevance of Investment Risk to the General Rate Application – Recommended Findings

MPI drives the bus when it comes to key decisions including the Request for Proposals relating to ALM and the review of Mr. Viola's evidence

To the extent, the corporation undertakes undue risks for potential reserves, it has implications for total equity and RSR

To the extent that portfolio decisions are within its legislative mandate, MPI does not require Ministerial sign-off inviting a prudence review of decisions within the legislative mandate

Ratepayers through the corporation pay for external advisors and fund managers

Forecasts of investment income important to calculation of other sources of revenue needed to break even

# Does MPI Mischaracterize the Investment Debate?

In defending its management of the investment portfolio, at times, MPI appears to characterize the issue as one of assuming more risk

See for example, Johnston, page 119

For a comparison of the MPI portfolio performance to CCSB, TRAF and WCB please see Johnston, page 309-310

For a comparison of the MPI portfolio performance to SGI please see Johnston, 311

## The Issue:

- not necessarily about accepting more risk
- about optimizing return given risk tolerances recognizing the insights of modern portfolio theory

# Modern Portfolio Theory teaches the value of not putting all one's eggs in one basket

Adding assets to a diversified portfolio that have correlations of less than one with each other can actually decrease portfolio risk without sacrificing return

Johnston, 1529

The risk in a portfolio of diverse individual stocks will be less than the risk inherent in holding any one (1) of the individual stocks provided the rest of the various stocks are not directly related

Johnston, 1529



# Modern Portfolio Theory teaches the value of not putting all one's eggs in one basket (continued)

There is value in not putting all your eggs in one basket

Johnston, 1529

When we look at the investment risk assumed by Manitoba Public Insurance or Manitoba or SGI, one would want to take into account the diversification of their portfolios

Johnston, 1530

See also the discussion of different correlations in multiple currencies and diversification benefits at Johnston, 1066



# There are grounds to be concerned that the Corporation accepts undue risk for insufficient benefit

in 2015/16, the Basic program suffered a loss of about \$4 million in terms of investment income on a portfolio of over \$2 Billion

Johnston, 1033-1034

A major driver of the loss on portfolio in excess of \$2 billion was a significant write-down of impaired Canadian equity in excess of \$25 million

Johnston 1034

# There are grounds to be concerned that the equities portfolio is unduly concentrated in Canadian Equities

Please turn to CAC Exhibit 16, slide 38

In terms of public equities:

## Manitoba Public Insurance

Canadian Equity at 67%

US equity at 33%

Zero Allocation to International Equity

## Saskatchewan Government Insurance

Canadian Equity at 47%

US equity at 31%

International Equity at 23%

Johnston, 1061-1062, Exhibit CAC - 16, slide 38

# **MPI does not look like other well regarded portfolios**

Please turn CAC 16, slide 39

See also Johnston 1063

# **There are grounds to believe that there may be opportunities to reduce portfolio risk through diversification while maintaining or improving return**

**MS. KATHLEEN MCCANDLESS:** And if you're able to answer this, please do. Based on what you know as the Minister's delegate today and in your capacity as a co-chair of the investment committee working group, if there were a change requested to add international equities at this time, would there be concerns from the Department's perspective?

**MR. GARRY STESKI:** No, there wouldn't.

Steski, 1389

# **There are substantive grounds to closely supervise the Corporation's Approach to Asset/Liability Matching Analysis**

CAC expressed concern that undue risk is being placed on Manitoba consumers as a result of investment portfolio selections. The ALM study conducted by AON in 2014 was based on accounting metrics which were driven by concern with short-term volatility, and Accumulated Other Comprehensive Income (AOCI) was excluded from the metrics.

As a result, as stated by Mr. Viola, MPI's portfolio design is being driven by inappropriate selection of risk and return metrics, understating the risk, and unduly constraining the portfolio outcomes.

## **There are substantive grounds to closely supervise the Corporation's Approach to Asset/Liability Matching Analysis (continued)**

The AON ALM study, according to CAC, has limited utility in allowing the Corporation to make portfolio decisions, given the return/risk metrics and excessive constraints, and remarked that Mr. Viola's evidence was that he viewed the ALM study as understating the risks of the Corporation, being market risks.

An emphasis by MPI on short-term rate stability leads to an excessive level of risk for the investment returns gained

Board Order 162/16 - page 50

# **The Corporation's Performance to Date in terms of its Asset/Liability Matching Study does not inspire confidence**

MPI directed to file an ALM or assets liability matching study for the purposes of the 2018/'19 General Rate Application

Johnston, 1036

MPI could not meet a filing date for – to file its asset liability matching study for the purposes of the 2018/'19 General Rate Application.

Yien, 1051-1052

# Act in Leisure – Repent in Haste – Race Against Time

**MR. BYRON WILLIAMS:** In essence, the Corporation's move(d) from suggesting a six (6) month structure to a two and a half (2 1/2) month race against times, sir?

**MR. PETER YIEN:** It is a two and a half (2 1/2) months of the same activity performed normally over a six (6) month period. That would be true.

Yien, 1052-1053

See also pages 1036 to 1045 for a discussion of tight time frames



# Corporate Bonds – Act in Leisure – Repent in Haste

**BOARD MEMBER VANDEWATER:** So the absence of corporate bonds, heretofore, probably has hurt the performance somewhat? If they had been under the FAA.

**MR. GARRY STESKI:** Yeah that – I would generally agree with that, yes.

Steski, 1427

# Recommendation regarding corporate bonds is not new

Expanded Commitment to Corporate Bonds Recommended by AON 2014

Johnston, 1058

See also AON report Phase II

CAC noted also that there was an unrealized opportunity for investment in higher yield corporate bonds and queried how MPI's investment portfolio is performing relative to other significant organizations

Board Order 128/15 - page 46

# Recommendation regarding corporate bonds is not new (continued)

Manitoba Public Utilities Board also asked Manitoba Public Insurance to look at this issue in Order 128/15

Order 128/15, page 75

The Board sought an update on the status of the use of corporate bonds in the bond portfolio, including insight into their performance.

Johnston, 1059

# There is nothing radical about Crown Auto Insurers investing in Corporate Bonds

SGI and ICBC good comparators for Corporate Bonds

that analysis, the Corporation looks to Saskatchewan Government Insurance and The Insurance Corporation of British Columbia, as good comparators.

Johnston, 1060

# MPI does not Act until 2017 – then becomes concerned it has overreacted

Manitoba Public Insurance has indicated that they have a plan to significantly alter the investment in corporate bonds

Yien, 1047

Mr. PETER YIEN: And then finally, when we had looked at the overall bond strategy we also realized that we couldn't just make that bond strategy just on bringing the rate down alone. It can't be the driver of our investment. We can't put our entire \$3 billion portfolio at risk just because we want to lower the rate of roughly .8 percent. So therefore we also require the ALM study, and as a result we started to accelerate that. So that's really the – the genesis of why we held back, and why we accelerating it.

Yien, 287-288 (emphasis added), see also 1048 - 1049

# **There may be a significant opportunity related to Corporate Bonds**

Manitoba would be supportive.

Steski, 1398

# Act in Leisure Repent in Haste – Has MPI put key threshold elements of Mr. Viola's Work in Phase 3 rather than Phase 2

Mr. Viola - start with the framework, - solve the problem, and then get to the other issues, being portfolio metrics and oversight

Johnston, 1043

MPI relegates key framework elements to Phase 3 (indent and bullet)

- de-linking discount rates, Yien, 1041-1042
- evolved risk framework, Yien, 1042
- Explicit Risk Management, and minimum risk portfolio, Yien, 1042
- See also CAC Exhibit 16

# Will Mercer's analysis be unduly constrained?

MR. PETER YIEN: No. Absolutely it would be the contrary. Knowing the limits is a critical input to – to conducting the asset liability matching study.

Yien, 1056

MR. BYRON WILLIAMS: [...] you've set the RSR capital target as a key constraint for the asset liability matching study?

MR. PETER YIEN: It is one (1) of the constraints, but certainly would be one (1) of the key constraints. Yes.

Yien, 1056-1057



# Will Mercer's analysis be unduly constrained? (continued)

MR. BYRON WILLIAMS: You're not looking at other scenarios of risk tolerance then?

MR. PETER YIEN: There are other scenarios, but relative to rate stabilization reserve limits, that is the – that is what the Board has decided on.

Yien, 1058

# MPI Drives the Bus

**MS. KATHLEEN MCCANDLESS:** Now, who is ultimately responsible for the investments of MPI?

**MR. GARRY STESKI:** The Corporation is ultimately responsible.

Steski, 1373

**ADM has no voting ability on MPI's Investment Committee**

Steski, 1376

# MPI Takes the Initiative

Recommendations to the Investment Committee Working Group  
brought by Corporation

Steski, 1379

Changes to investment policy statement brought forward by MPI

Steski, 1382

# Key decisions do not require Ministerial Approval

**MS. KATHLEEN MCCANDLESS:** And just –you – to clarify, we did discuss this just a minute ago but, for example, if MPI wanted to make a change to the fund that involved a change in the allocation or the mix of investments but any of those investments were already permitted under the Act, would MPI need to go to the Minister for approval?

**MR. GARRY STESKI:** No.

**MS. KATHLEEN MCCANDLESS:** And would that be the case even if the change required a change to the investment policy statement itself?

**MR. GARRY STESKI:** Yeah, if – if they wanted to change an allocation in the investment policy statement, that wouldn't be – the Minister wouldn't need to approve that.

Steski, 1386-1387

# Department relies upon MPI for key elements of Due Diligence

MS. KATHLEEN MCCANDLESS: So we discussed tho – those changes that would require an Order in Council being changes that would fall outside the permitted class of – classes of investments under the Financial Administration Act; yes?

MR. GARRY STESKI: Yes.

MS. KATHLEEN MCCANDLESS: When that type of a requested change is made, does Finance do its own due diligence? Would that be the type of circumstance where it does its own due diligence?

MR. GARRY STESKI: No. Again, we would rely on the investment department's work on that.

Steski, 1395

# MPI Drives the Bus

**MS. KATHLEEN MCCANDLESS:** So, in summary, when it comes to making decisions about changes to MPI's investment portfolio, who's the driver of the bus?

**MR. GARRY STESKI:** The Corporation.

Steski, 1394-1395

# **MPI Guides ALM study**

**Investment committee working group did not have a hand in the development of the scope of Asset Liability Management Study**

**Steski, 1396**

**ADM did not personally review the request for proposal that was issued**

**Steski, 1396**

**ADM did not review Viola's evidence which is an important element of ALM study**

**Steski, 1421**

**Province does not pay for ALM Study**

**Steski, 1424**

# **Recommended findings regarding role of information technology expenditures in driving basic expenditures**

Amortization including deferred development of Information Technology projects is a significant driver of costs for MPI corporate and basic

Amortization expenses related to deferred development have shown significant growth in both absolute and percentage terms

There are significant expenditures pending relating to IT projects which are likely to have a significant impact on basic



# Recommended Findings regarding Information Technology expenditures and business process maturity

MPI continues to operate at a low level of business process maturity

MPI is investing significantly more in Infrastructure and Operations than its peers including significantly higher investments in staffing, outsourcing and software

# Recommended Findings regarding the Physical Damage Re-engineering Project

PDR was initiated in the absence of a well articulated business case and the project has changed “dramatically” in scope, resulting in the cancellation of 6 projects and the putting on hold of another

Key programs such as CCRS lack an independent business case

Contrary to good practice as articulated by the Gartner group, operating and maintenance costs have been excluded from the calculation of the Physical Damage Re-engineering Project costs

More than \$10 M in costs associated with closely linked projects including Predictive Analytics, Centre of Excellence and Shop Management have been excluded from the calculation of the Physical Damage Re-engineering project costs (in whole)

## **Recommended Findings regarding the Physical Damage Re-engineering Project (continued)**

Notwithstanding the exclusion of the capital costs of Predictive Analytics from the cost side of the equation of the PDR cost/benefit analysis, MPI has included the savings from predictive analytics on the benefits side

Assessment of business case is inconsistent with good practice in that it did not consider or employ MPI weighted cost of capital

Calculation of Net Present Value of PDR program cannot be relied upon for purposes of this process

# **Recommended Findings regarding IT portfolio management including AOL/CARS**

**MPI has not demonstrated that it is practicing modern Information Technology portfolio management or optimization**

**Absence of financial information related to next big expenditure AOL/CARS**

# Amortization and Depreciation Account for a Significant Amount of Corporate and Basic Expenses

Depreciation and amortization account for in the range of 10 percent of all Basic expenses in 17/18

Yien, 1282-1283

The forecast expense for depreciation and amortization for the Corporation in 17/18 is 26.792 million, its forecast for the test year of 18/19 on a corporate basis to be 32.1 million

Yien, 1284

See also PUB MPI 2-14

# Amortization and Deferred Development has been growing fast at the Corporate level

The compound annual growth rate for the four (4) years running from 13/14 to 16/17 was 17.5 percent

Yien, 1285

The forecast for the current year of 17/18 out to 19/20 is a compound annual growth of 13.3 percent

Yien, 1285

# Amortization and Deferred Development has been growing fast at the Corporate level (continued)

In the 2012/13 year the amortization and deferred development costs actuals were \$8.8 million

Yien, 1285

By 16/17, they were \$16.859 million

Yien, 1285

And moving out to 18/19 roughly \$26 million

Yien, 1285

# A Significant Proportion of total Project Costs are borne by Basic

278 million total corporate, roughly 205.6 million are associated with Basic deferred development

Yien, 1288

See also Exhibit PUB 2-16

See also PUB 1-17 for total corporate project costs and their allocation to Basic on a percentage figure.

Yien, 1289-1290



# IT personnel remain at a relatively high level since at least 2012/13

DR. BYRON WILLIAMS: [...] the IT personnel levels have stayed at a – a relatively high level since at least 2012/13?

MR. PETER YIEN: Yeah, I would say it stayed consistent pretty much, yes.

Yien, 1291

See also PUB MPI-1-31

# IT – MPI is unlike its peers in it staff expenditures

MPI spends 63 percent of the IT budget on personnel versus 44 percent for the peers.

34 percent of MPI's IT staff is made up of contractors versus 17 percent for the peers.

Geffen, 1151

# There should be opportunities to reduce staff over time

as organizations move to a more managed services environment some – there is – nec – necessarily retained staff required to do planning, direction, some internal support. And so as part of that mi – as you mature that relationship you would like to reduce the number of retained ser – retained staff as you – as you develop a better relationship and getting better at more effective services from your third-party services provider.

Geffen 1224-1225 (emphasis added)

# There should be opportunities

MR. MARTIN GEFFEN: So they're higher than the peers, and so that gives us an indication that they're probably somewhat higher than – than – than would be expected. [...]

PDR is ramping down, and so we should actually be coming – getting to a more steady state [...]

You know, on one hand, it is more than peers, and so the – to that degree with – it is higher than what we would expect. On the other hand, we do know that there's a – a heavy workload [...]

Geffen, 1157-1158 (emphasis added)

# It is legitimate to consider how much an organization can take

how much change organizations can – can act – can take, so in certain terms of both being able to finance the – the, you know, fund from this projects, and then actually incorporate – incorporate some of those changes.

Geffen, 1152

# Business Process Management Matters and Remains low

So if you were to have, you know, disciplines where you've actually identified – you have structured ways of defining what your business processes are, and you have automated business process management tools in place, you have a better understanding of turnaround **16** times, staff allocation, resource utilization – utilization. You have better ways of identifying opportunities to – to optimize benefits.

Geffen, 1165 (emphasis added)

Business process management maturity remains generally low, one point six (1.6) . . .

Geffen, 1163-1164 (emphasis added)

# Benefits Realization Immature

Our findings from the MPI assessments are that the MPI value management process is instituting a disciplined use of business cases as input to the initial investment decision. It has not matured to the point of using these as part of the benefits realization and evaluation.

MPI Exhibit 47 per Gartner

# Comparison to Peers

Yeah, so we pick peers that have similar workload and complexity. So when we – we – in – in the comparative numbers over here, we're comparing MPI to organizations that have similar workload and complexity, and in – to that extent, a similar IT footprint.

Geffen, 1161

Note: It is the process maturity benchmark scorecard that is not updated not the peer comparisons

Geffen, 1226



# Poor Performance Relative to Peers in Infrastructure and Operations

See 2018 GRA BMK, Attachment A, “A Presentation to the Manitoba Public Insurance Board of Directors” by Gartner Consulting, January 2017, PDF Page 14

Comparison of the overall infrastructure and operations spend of Manitoba Public Insurance as compared to peers

Geffen, 1216 (see more generally 1217 - 1219)

# Poor Performance Relative to Peers in Infrastructure and Operations

Total:

MPI 15/16 at 24.1 million

Geffen, 1219

Significantly higher than the peer average of 17.8 million?

Geffen, 1219 -1220

Significantly higher even than the peer 75th percentile at 20.2 million

Geffen, 1220

# Poor Performance Relative to Peers in Infrastructure and Operations

IT full-time equivalents are 45 percent higher than the workload peer;

IT spending is 35 percent higher than workload peers.

Geffen, 1221

# Dramatic Changes in PDR

MR. MARTIN GREEN: [...] I think that the PDR Program itself has changed quite dramatically over the six (6) years, or how – however long it's been in – in – in play.

Geffen, 1200

See also Geffen, 1192 – 1193

# CARS not Replaced

MR. MARTIN GEFFEN: My understanding is that CARS – that part of the PDR project was to replace the CARS.

Geffen, 1186

# A high proportion of other cancelled projects

MR. MARTIN GEFFEN: . . . As of last year, there were twenty (20) projects. Eight (8) were complete – eight (8) were complete, seven (7) cancelled, and five (5) were going ahead. And so yeah, it looks – it – it is a high – a high proportion.

Geffen, 1270

## And now Remote Estimating on Hold

**DR. BYRON WILLIAMS:** The seven (7) that went down, and since then, remote est – estimating has – has been put on hold.

**MR. MARTIN GEFFEN:** Exactly. It's being revisioned as this – this strategy, yes.

Geffen, 1242

# Changes in leadership

In 2016, the Gartner Group was reporting that an executive director had been appointed to the PDR project with clear structures for program governance, delivery, an overall project structure

Geffen, 1237-1238

There is no longer an executive director for this program

Geffen, 1238



# The Remote Estimating Budget is Perfectly Opaque

**MR. PETER YIEN:** Yeah, so like, if I can just repeat it, just for perfect clarity. The original budget was 1.2 million and then the additional forecast added 1.8 million as part of the revision, which brought it to 1.8 plus 1.2 which was the overage that you were talking about. So, that brought it to \$3 million. And we revisioned it and then it brings it back to \$2 million.

**DR. BYRON WILLIAMS:** So your project on remote estimating is now \$2 million, but you've put the project on hold, sir, because of a concern about cost overruns in terms of the – the equipment; is that not – was that not Gartner's evidence on Tuesday?

**MR. PETER YIEN:** Yep, my understanding that's correct.

Yien, 1520

# The Remote Estimating Budget is Perfectly Opaque

DR. BYRON WILLIAMS: So while the budget has been revised downward remote estimating has been put on hold because it's, again, gone over budget, sir?

MR. PETER YIEN: Just one (1) second.

(BRIEF PAUSE)

MR. PETER YIEN: So – so you're correct, we put it on hold and the reason why we put it on hold is we have to assess whether it's worthwhile continuing, and whether we would actually realized the associated benefits. So that's why it's sitting at 1.2.

Yien, 1520

# **There is a late breaking rural strategy that MPI is not able to tell us much about**

**DR. BYRON WILLIAMS:** And do you have any sense in terms of when the rural strategy will be unveiled or finalized, sir?

**MR. PETER YIEN:** I'm not sure. I'm going to just check.

**(BRIEF PAUSE)**

**MR. PETER YIEN:** So that's definitely a board agenda and that's part of our business strategy as part of the December 15th finalization of that.

**Yien, 1532-1533**

**See also Yien, 1298-99**

# Contrary to Best Practice - Business Cases Appear Lacking for the Revamped Projects

MR. MARTIN GEFFEN: So what we like to see is as it – as a – as a best practice is that – that as you create a new project, you do – if it meets a certain threshold, you would expect to see a business case for that project.

Geffen, 1268-1269

THE CHAIRPERSON: If – if CCRS was an accumulation, was there a business case for CCRS separate from the entire PDR program?

MR. MARTIN GEFFEN: Not to – not to my knowledge.

Geffen, 1269

MR. MARTIN GEFFEN: We had asked for revised business cases, and none were available.

Geffen 1198 (emphasis added)

## The Estimate of Net Present Value is Lower

MS. KATHLEEN MCCANDLESS: There's also been a reduction in the net present value, yes?

MR. MARTIN GEFFEN: Yes.

MS. KATHLEEN MCCANDLESS: And that was – last year was assessed at \$18 million.

MR. MARTIN GEFFEN: Yes.

MS. KATHLEEN MCCANDLESS: And now it's down to the \$13.7 million, yes?

MR. MARTIN GEFFEN: Yes.

Geffen, 1209

# The Estimate of Net Present Value is Lower (continued)

MR. MARTIN GEFFEN: And all of those (benefits) have been delayed due to the del – the delays in – in – in getting these projects up and – up and running.

Geffen, 1212

# The Cost Benefits Assessment does not Inspire Confidence

Operating and Maintenance Costs are not part of the Assessment of Business Value

# Total cost of Ownership

MR. MARTIN GEFFEN: [...] And what we recommend to our clients is that they focus not just on the procurement and acquisition and implementation costs, but on the ongoing operate – on the – the ongoing operating costs as well.

Geffen, 1232-1233

See also Geffen, 1206-1207

MS. KATHLEEN MCCANDLESS: This analysis did not have any costs assigned to the project after completion, yes?

MR. MARTIN GEFFEN: Correct.

Geffen, 1205-1206



# Gartner did not do an assessment of benefits of PDR

**MS. KATHLEEN MCCANDLESS:** So Gartner did not perform its own independent evaluation?

**MR. MARTIN GEFFEN:** We did not do a detailed assessment of – over the source of the benefits, correct.

Geffen, 1205

# More than \$10 Million in Closely Related Capital Costs have been wholly excluded

## Predictive Analytics and COE Not Part of PDR Budget by MPI

The predictive analytics but of \$2.2 million was not part of the \$65.5 million budget.

The \$6.3 million Centre of Excellence Project was not part of the \$65.5 million budget

Yien, 1517

See also Geffen, 1253, lines 19-20, See also Geffen, 1257-1258 & 1259 and  
Yien, 460-462

# More than \$10 Million in Closely Related Capital Costs have been wholly excluded

DR. BYRON WILLIAMS: And, sir, should we conclude from this that Shop Training Management, that expenditure, will continue, but it will no – just simply no longer be counted against the PDR budget?

MR. PETER YIEN: Subject to check, yes. Yes.

Yien, 1512

# But predictive analytics benefits captured in benefits stream

DR. BYRON WILLIAMS: And directing your attention on the left-hand side to Predictive Analytics, which is about the fourth line down, MPI – and through Gartner is projecting benefits of half a 1 million dollars in '18/'19 and a million annually 2 thereafter, agreed?

MR. MARTIN GEFFEN: Agreed.

Geffen, 1254-1255

# But predictive analytics benefits captured in benefits stream

DR. BYRON WILLIAMS: Would it be fair to suggest that the predictive analytics benefits of 16 million a year are linked to the Predictive Analytic Project?

MR. MARTIN GEFFEN: Yes, they would be.

DR. BYRON WILLIAMS: And that's what you meant by – when you said the predictive – the Predictive Analytic Project is tightly related to achieving PDR success?

MR. MARTIN GEFFEN: Yes. So the – that – that's – we – sorry, the – yeah, so predictive analytics should enable cost savings due to avoid of – fraud, and predictive analytics models could identify opportunities for doing, you know, process optimization, yes.

Geffen, 1255 (emphasis added)

# Cost of Capital does not reflect risk or MPI estimated costs of capital

MR. MARTIN GEFFEN: So we selected that, not based on the MPI risk assessment at all, but based upon a – a – kind of a – a – the consumer price index, and that for – we just picked that is a – a – a standard benchmark. So it does not reflect risk at all.

Geffen, 1208

# Cost of Capital and the Tipping Point

DR. BYRON WILLIAMS: And, sir, just so I understand the – the cost of capital selection gives insight into – into the tipping point in terms of whether one is supportive of the project, or indifferent to the project, or chooses not to – to select the project. Would that be fair?

MR. MARTIN GEFFEN: So – it – anyone of those financial analyze – those financial analyses would be used to do exactly that, decide whether you want to invest or not invest, and the – it – is the – those – those analyses combine entire cash flow. So the – the kind of projected cash flow over time, both the spend and the projected benefit to revenue and – and – and the cost of capital.

Geffen 1260

# Good Practice suggests using Corporate Cost of Capital

DR. BYRON WILLIAMS: And did you ask MPI whether they had a cost of capital?

MR. MARTIN GEFFEN: I can't recall that. I really don't know.

DR. BYRON WILLIAMS: And – and with respect, sir, that – that would seem to me, to be almost the – the starting pla – place for almost every bit of financial analysis I've ever seen?

MR. MARTIN GEFFEN: Agreed. It was – it's was a piece of analysis that – that we – that we looked to do in this project and – did this with - - as I say, it's something that we should have asked MPI to do.

Geffen, 1260-1261



# What happens to anticipated benefits of Remote Estimating now it is on hold

MR. MARTIN GEFFEN: So – yes, so that the PDR is – was – is managed as – as a program, which is a number of different projects or initiatives, and there's a series of benefit streams that would – were laid out for the program itself, including the internal efficiencies – efficiencies from – from the repair shops and from the loss of uses and so on and so forth. And one (1) of the estimates would have been for the more – being more able to – being able to work more effectively with – with remote and rural shops.

Geffen, 1246

See also Geffen, 1247

# Significant (albeit diminishing) Risks Remain - CCRS

MR. MARTIN GEFFEN: [...] MPI has identified a kind of, new and different way of doing accident pro – or claim profiling and claim processing by working – by identifying a profile up front. This is something that MPI has developed and is providing intro – intellectual property to Mitchell to – to – to build out in software. So it's not even – doesn't have a track record in – hasn't been done – many times be - - before by other software vendors. And given that, it's always – we need to mana – manage that risk.

Geffen, 1252

# Gartner Group had great confidence that the project would be on budget – prior to cancellation of 7 projects

MS. KATHLEEN MCCANDLESS: [...] "Given the historic experience the project reporting and the relatively recent re-based lining, there is a high level of confidence that the overall program will be completed within the original \$65.5 million budget." Yes?

MR. MARTIN GEFFEN: Yes.

MS. KATHLEEN MCCANDLESS: And so that was the state as of last year?

MR. MARTIN GEFFEN: Correct, yes.

MS. KATHLEEN MCCANDLESS: Prior to the additional seven (7) cancelled projects; yes?

MR. MARTIN GEFFEN: Correct.

Geffen, 1197

# Where is the Evidence of IT Portfolio Management

MR. MARTIN GEFFEN: Sure, yes, although application portfolio management is a pretty well understood discipline that – that, yes, it's about understanding what applications are in place. And, as you said, we – we agreed – when we look at – application portfolio management, we – we look at technical health, business health and – and cost to operate. So those are some of the things that – that we like to see in – in application portfolio management.

Geffen, 1234-1235

MR. MARTIN GEFFEN: [...] I keep coming back to those three (3) things: figure out cost and – and technical health and business value.

Geffen, 1235-36

## **MPI is unable to Provide Key Financial Elements related to two key Applications, AOL/CARS**

**DR. BYRON WILLIAMS:** And it's fair to say that Manitoba Public Insurance is maintaining the existing CARS and AOL systems in order to provide well-defined and specific business functionality from which the organization derives quantifiable business value – value?

**MR. PETER YIEN:** Yeah, correct. These systems have been in place for 20 plus years, so, yes.

Yien, 1301-1302

# **MPI is unable to Provide Key Financial Elements related to two key Applications**

**DR. BYRON WILLIAMS:** And I'll suggest to you, sir, that currently there is not a project charter, high level, or detailed business case and associated analysis for the rebuild versus replace of Autopac online or the claims administration reporting system. Would that be fair, sir?

**MR. PETER YIEN:** You're correct.

Yien, 1302

# MPI does not have the cost of maintenance associated with CARS/AOL

DR. BYRON WILLIAMS: [. . .] .would you have an estimate of the cost of maintenance associated with these specific applications, sir?

MR. PETER YIEN: Let me check on that.

(BRIEF PAUSE)

MR. PETER YIEN: My apologies, Mr. Williams. Your question is a good one. The complexity lies in the software itself in terms of allocation of the maintenance between AON/CARS. We –we don't have that and that's something that needs further work.

Yien, 1306-1307



# Operating and Maintenance Costs Associated with PDR still not filed

## Undertaking #10

MPI to provide information as to the estimated operating costs for the PDR program, including maintenance cost, licensing fees and redevelopment.

## RESPONSE:

The cost of maintenance and licensing fees are commercially sensitive and contractually, MPI is currently unable to release this information. However, MPI will work with the vendor to seek approval to release this information and will provide an answer if approved.

Exhibit, MPI - 50



## **Operating and Maintenance Costs Associated with PDR still not filed (continued)**

MPI advises that it will not be filing anything further to Undertaking #10 (filed as Exhibit MPI – 50)

Consideration can be given to an Order compelling production in confidence or sworn confirmation that the information is not available

# Software Provides an Important Opportunity for Savings (maybe move up)

Software continues to provide the most immediate area for cost savings.

Geffen, 1221

With regard to the IBM contract, there is a higher yearly cost than might be expected

Geffen, 1222

For a discussion of the opportunity for savings, see Geffen, 1222-1223

# Recommended Findings Relating to the Administration and Reserves of the Personal Injury Protection Plan

The Corporation booked significant adverse in Personal Injury Protection Plan claims in 2016/17 related to the 2011/12 through 15/16 years

The lack of confidence in current reserves can be attributed at least in part to a failure to follow reserving practice guidelines

MPI has not complied with the 2015 PUB Order to seek further insight into longer term claims from the SAAQ (Quebec)

The challenge in meeting the permanent impairment benefit can be attributed at least in part to significant staff churn and turnover

MPI would benefit from an external review of claims reserves related to the Personal Injury Protection Plan

# **\$58.7 Million of bad news for PIPP 2016/17**

In the 2016/'17 fiscal year, Basic policy liabilities experienced a net unfavourable runoff of \$58.7 million

Johnston, 1091

Ultimate loss estimates from 2010/'11 through '15/'16 policy years were increased by about 44/45 million over the preceding year's estimates

Johnston, 1092-1093

# Adverse Development driven by more claims remaining open beyond 60 months

The unfavourable runoff was driven by a change in the percentage of injury claims remaining open beyond sixty (60) months - especially since the 2010/'11 year

Johnston, 1091-1092

# Actuarial Assumptions responding to uncertainty in claims reserves

One (1) of the things that's been driving the actuarial assumptions, October, and then February reports was the increased uncertainty related to case reserve levels, especially for less than forty-eight (48) months.

Johnston, 1095

# Problems in Reserving

**DR. BYRON WILLIAMS:** And ultimately, my understanding, sir, is that certain claims were not being reserved for life per established reserving guidelines, and as such, were insufficient, agreed?

(BRIEF PAUSE)

**MR. LUKE JOHNSTON:** So we have – we have two (2) types of claims. There – there is – we have more than two (2) types of claims, but in terms of lifetime reserving, there's catastrophic claims. In other words, very obvious that this is a lifetime claim. There's no chance of recovery.

And then we have non-catastrophic claims where there's a risk of a lifetime benefit, but there's also high potential of recovery. We have a methodology for non-catastrophic claims, which essentially, that's a lifetime reserve, and then adjust that reserve down for assumed recovery. [...]

## Problems in Reserving (continued)

MR. LUKE JOHNSTON (CONTINUED): In the non-catastrophic claim bucket, it appears that there is optimism in terms of the belief that that claimant could get back to work, or – or the case manager could get that claim back to work, and it would not be a lifetime claim. And in – in those cases, kind of the global average reserve wasn't put up, and we are under reserve for the – for that reason.

[...]

DR. BYRON WILLIAMS: And there is somewhere between thirty (30) and forty (40) claims that are now expected to persist beyond sixty (60) months, agreed?

MR. LUKE JOHNSTON: Agreed.

Johnston, 1097-1098



# Case Reserving is being Removed from Case Managers

DR. BYRON WILLIAMS:[...] benefit administrators and case managers to a centralized reserving unit, sir. Is that correct?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: The only – yeah. The only thing I'd add to that is it's – we're transitioning that work from case managers to the centralized reserving unit from March 1st of this year to October 31st of – of this year. October 31st isn't – isn't by accident.

Johnston, 1099-1100

# Challenges in Consistency and Reliability of Reserves

MR. BYRON WILLIAMS: [...] one (1) of the motivations for that was to improve the – the consistency and reliability of reserves, case reserves; agreed?

MR. LUKE JOHNSTON: Agreed.

Johnston, 1100

# Challenges in Consistency and Reliability of Reserves (continued)

MR. LUKE JOHNSTON: So there is kind of a concern there that we didn't have enough reserves. We asked the claims division to look into that issue for us, and it was confirmed that we probably needed an increase in our case reserves. And one (1) of the outcomes of that was to create a centralized reserving department to make sure that all claims in this kind of bucket – would – being – the bucket being more than twenty- four (24) months – were reserved timely and appropriately going forward.

Johnston, 1096 (emphasis added)

# A Management and Forecasting Issue

Failure to follow reserving guidelines

Failure to ensure that reserves are timely and appropriate is a management and forecasting issue

# Is RSR there to shield MPI from a failure to follow reserving guidelines?

PIPP: Beginning approximately in accident year FY 2010/11, there was an unexpected increase in the number of lifetime injury claimants. In FY 2015/16 and FY 2016/17, the claims liabilities for Weekly Indemnity were increased by \$54 million and \$36 million respectively to account for this change in experience.

Exhibit MPI - 37

# Is RSR there to shield MPI from a failure to follow reserving guidelines?

Shock to the bottom line in 2015/16

Shock to the bottom line in 2016/17

Adherence to reserving guidelines would have mitigated – would have led to better forecasts and better reserves

## Staff Turnover and Churn (see PUB 2-33)

Benchmark of permanent impairments being outstanding for less than twenty-four months benchmark is not being consistently achieved between February 2013 year to dates to the February 2017 year

Johnston, 1102

And one of the drivers of the challenges in meeting that 14 benchmark has been unforeseen staff turnover and internal resource churn

Johnston, 1102-1103, PUB 2-33

Unforeseen staff turnover and resource churn reflects management challenges

# The Tail Factor Matters

**MR. LUKE JOHNSTON:** The tail-factor is important because it affects all years, essentially, so, from 19 – 1994 claims are not finished being settled. So, if we do change the tail factor, then it would impact every year of the PIPP program.

Johnston, 1090-1091



# The Tail Factor Matters but there is Significant Uncertainty about the Tail Factor

DR. BYRON WILLAMS: [...] expectations of development beyond the ten (10) years are integral to the analysis of the total estimate of ultimates; [...]

MR. LUKE JOHNSTON: Agreed. One (1) of the most difficult parts of making projections on the original PIPP program was no information about the tail, so we're getting more information now as time passes.

Johnston, 1086

# Tail Factors are a significant source of risk and uncertainty

With regard to the total ultimate estimated for any particular policy year for accident benefit weekly indemnity, 47 percent of the total ultimate paid takes place after year nine

Johnston, 1088-1089

DR. BYRON WILLAMS: that long-tailed nature of the claim causes this type of claim to be highly sensitive to interest rate changes; that would be fair?

MR. LUKE JOHNSTON: That's true, that – these types of claims really are the whole reason why we have close to 2 billion in claims liabilities and a – and a fixed-income portfolio to match. Most – most of that's for PIPP claims like – of long-tail nature.

Johnston, 1089

## A Key Benchmark is Not being met

MR. BYRON WILLIAMS: [...] One (1) of the objectives, one (1) of the benchmarks was to have less than 10 percent of open claims older than five (5) years, sir; agreed?

MR. LUKE JOHNSTON: Agreed.

MR. BYRON WILLIAMS: And that one (1) of the challenges you're articulating is that the percentage that's remaining open is as of February 2017, would be at about 14 percent; correct?

MR. LUKE JOHNSTON: Yes.

Johnston, 1101, PUB 1-61

# Long Term Claims Matter and Drive Risk but Ernst and Young does not address

Any longer tail open claims were excluded from that analysis, as they have yet to close

Johnston, 1103

They wouldn't have looked at the longer tail open claims

Johnston, 1103

Only fully developed claim years for each duration band, were evaluated

Johnston, 1104

# A matter of some puzzlement

At approximately the same time Ernst and Young is waxing rhapsodic about BI3, MPI was

- removing reserving from adjustors
- experiencing material negative development
- articulating challenges with significant staff churn

## Recommend external staff review

There are North American experts in no-fault who are retained by insurers to offer an independent review of claims reserves and to provide advice on experience elsewhere.

Johnston, 1104

There are offerings in the marketplace of North American experts in no-fault who will come in and assist insurers in examining their reserves and the reserving practices

Johnston, 1104-1105

## **Manitoba Public Insurance has not considered bringing in that kind of expertise?**

**MR. LUKE JOHNSTON:** So right now we don't – we haven't done that or – or have plans to do so. We did just meet with the other Crowns in terms of their injury claims handling practices, but what you're describing sounds more of a consulting type roll where someone comes in and looks at the overall process. We – we don't have – we haven't done or we don't have plans to do that right now.

Johnston, 1105

## **Did not gather long tail experience from Quebec as per Order 128/15**

**MR. LUKE JOHNSTON:** Yes. And just to – just to make clear, obviously we take the Board Orders very seriously and we do intend to do the study. As you can imagine, with the rate indication this year, the liability review result in general, a new board, a lot of other things going on at the same time we did engage initial discussions with the Saskatchewan Government Insurance and I'll say SAAQ, so I don't have to repeat the pronouncement, Quebec. And there is definitely a willingness to do that. So – and Saskatchewan has provided information, but to do the this study, we just didn't have the capacity to do that this year. And so we apologize for not bringing that to the Board, but we 24 definitely intend to do it.

**Johnston, 1105-1106**



# Recommended Findings Relating to Road Safety Generally

The approach of MPI and the Province of Manitoba to road safety and loss prevention was in a relatively nascent state in 2013 compared to a number of other jurisdictions

Since 2013, MPI and the Province of Manitoba have taken actions to develop strategy, to bring more evidence based approach

However, there are still significant concerns related to rural Manitobans, vulnerable users including cyclists, motorcyclicst and others as well as significant opportunities

And while MPI asserts that its stakeholder committees are working well it is important to actually test reaction of stakeholders to stakeholder process

# Recommended Findings Relating to Loss Prevention

There are significant opportunities to modernize the fleet rebate program which are yet to be acted on

The introduction of Driver Safety Rating in 2010 was an important step forward

# Recommended Findings Relating to Loss Prevention and DSR

But there are significant concerns related to:

- Missed opportunities to identify primary and secondary vehicle driver in a manner that better addresses the intersecting risks of who is actually driving the vehicle
- Missed opportunities to set discount, premiums and surcharges in a way that better reflects risk
- Missed opportunities to enhance the overall understanding among drivers of how their driving behaviour can affect how much they pay for auto insurance
- Whether MPI can demonstrate that the proposed changes to the Driver Safety Rating surcharges are just and reasonable especially taking into account information related to the relative costs brought to the system by Drivers between 0 and positive 7 on the DSR scale

# Recommended Findings Relating to Loss Prevention and DSR

There is ample evidence to suggest that, in consultation with stakeholders:

MPI should review the effectiveness of its current rate-making methodology and the Driver Safety Rating (“DSR”) system in terms of associating insurance risk to the cost of insurance, including consideration of rate-making methodologies used in other Canadian jurisdictions.

# We are not there yet

As a jurisdiction, we're definitely not there in terms of the unnecessary and tragic social and economic costs of accidents

Keith, 876

“And we're not there in terms of the role that we play towards that”

Keith, 876-877

# Responding to the Regulatory Dialogue on Road Safety

Manitoba and MPI have made progress in developing strategy and improvements in evidence based analysis especially given where they were in 2013

# Significant Challenges were Identified in 2013

EXHIBIT NO. CAC-8: Excerpt from evidence of Mavis Johnson from 2013

The importance of using a safe system approach which would yield a realistic potential to reduce claims costs

The ability of MPI to optimize road safety expenditures was impeded by the absence of a road safety strategy

Within the context of an auto insurer, importance of critically evaluating costs and returns on investment of individual programs

Little information to demonstrate that individual programs or portfolios were optimally designed;

Keith, 872-873. See also Johnson, 2013, CAC – 8

# In Terms of Process and Strategy Significant Progress Has been made

The work that was done to create and formalize the three (3) year operational plan, as well as the frameworks for research, priority setting, program development, and program evaluation.

Keith, 875

Provincial Road Safety Strategy was released



# ROI on a Portfolio Basis for Loss Prevention

MR. WARD KEITH: [...] our objective is that on an overall basis, what we would hope to do is provide and we would provide this after our data sets are complete at the next hearing, at the next GRA, an overall score card that would help us to measure ROI at the portfolio level in terms of the money invested in loss prevention programming opposite the return on investment that we either can – and identify or anticipate with respect to claims costs.

Keith, 889

# A Quantum Leap Ahead of IT

MPI not there yet on road safety and loss prevention

But strides taken to give tools for portfolio management and relationship to strategy

Stands a quantum leap ahead of information technology (based on evidence proffered)

# Initiation of Gravel Pilot Project should be commended

The department identified a gap in programming aimed at poor driving behaviour on gravel roads, as a significant number of serious injury and fatal collisions occur in rural areas of Manitoba. In 2017, the Corporation in partnership with Royal Canadian Mounted Police is piloting additional enhanced enforcement to increase the perception of being apprehended by law enforcement and reduce poor or aggressive driving behaviour that result in serious injury or fatal collisions on these roads.

Exhibit MPI - 30

# Disproportionate Impact of Fatalities in Rural Manitoba

Long-standing theme, is the disproportionate representation of rural communities in fatalities

Keith, 912

Of 107 fatalities in 2016, "all rural," there were seventy (70) accounting for 65.4 percent of the total killed in that particular year.

Keith, 909

# Beware Gravel Roads

2012 and 2014, about 14 percent of all fatal crashes occurred on gravel roads.

And about 12 percent of all serious injuries in that same three (3) year period.

Keith, 917

# MPI Appears Reluctant to Acknowledge Opportunities in Loss Prevention

MR. BYRON WILLIAMS: So your evidence is, as we stand today, there are no untapped opportunities, sir?

MR. WARD KEITH: Well, I – I think there are always going to be emerging issues and emerging opportunities. But that I – what – what I – what I was getting at is, I don't believe that there are any initiatives that we are not pursuing today that we ought to be pursuing.

Keith, 877

# MPI does not readily acknowledge need for better data on Loss Prevention Side

MR. WARD KEITH: [...] With respect (to) broader loss prevention programs, we had not contemplated doing detailed costing studies. I think the data will be more readily available to do – to do return on investment calculations based on what we know the cost of those programs to be, both administratively and otherwise, and the return on – the return that we get from running those programs.

Keith, 896

If there's more deep analysis to go it would be on the road safety side

Keith, 896

# Data is Critical

Important that we base the analysis of the portfolio not on perception but on empirical evidence

Keith, 890

And good data provides an important tool in calculating value for investments

Keith, 890



# But in terms of DSR the Core Data Is Not There to Dig Deeper

MPI does not have data on primary and secondary drives or a current ability to link vehicle risk and driver risk in the way private insurers tend to have

MR. LUKE JOHNSTON: [...] Again, who is using the vehicle, how many vehicles that person has, how many people are using them, thing – things like that, yes.

DR. BYRON WILLIAMS: And that's a way to dig deep into the aggregate risk posed by both the vehicle and the primary driver, sir?

MR. LUKE JOHNSTON: That's correct.

Johnston, 1310

# Fleet Rebate Program – low maturity in terms of loss prevention

In the IBM report - basic fleet management was identified as an area of loss prevention with a relatively low maturity level in terms of alignment with loss prevention objectives

Keith, 930

# MPI unable to answer status of fleet rebate review

**DR. BYRON WILLIAMS:** [...] those issues still exist with regard to -  
- excuse me, with regard to the Fleet Rebate Program?

**MR. WARD KEITH:** I – I'm not sure I can answer that, Mr. Williams. I – I would have to go back and examine exactly what progress has been made on that particular program.

Keith, 930

## Fleet Rebate program has not had the attention of DSR

DR. BYRON WILLIAMS: [...] MPI is describing basic fleet management is a future opportunity for MPI, agreed?

MR. WARD KEITH: Yes. Thank you for pointing that out for me, Mr. Williams.

DR. BYRON WILLIAMS: And in terms of that future opportunity, it would be fair to say that while there was very extensive efforts done with regard to driver safety rating in '09/'10, and then more planned for this year, the Fleet Rebate Program has not been modernized to the same degree as driver safety rating, sir?

MR. WARD KEITH: I – I think that's fair. It – it has not been examined to the same level as DSR.

Keith, 932

# Fleet Rebate Programs offers an opportunity to incent change

DR. BYRON WILLIAMS: Yet those fleet owners, like individual drivers, have the power to change their behaviour and the power to change their employees' behaviour; agreed, sir?

MR. WARD KEITH: They – they may be able to influence their employees' behaviour. I – I would say yes.

Keith, 932

DR. BYRON WILLIAMS: So you have less confidence that the Fleet Rebate Program will be able to influence behaviour, sir?

MR. WARD KEITH: I don't know that there's less confidence as much as I'm just pointing out that it's not a direct implication to the drivers of fleet vehicles as it is with the DSR program.

Keith, 933

# No Specific Timeline for Fleet Rebate Review

**DR. BYRON WILLIAMS:** So recognizing Manitoba Public's – Insurance's statement that this is a few – future opportunity for MPI, what's the timeline for the realization of that opportunity, sir?

**MR. WARD KEITH:** I – I don't believe that we've established a specific timeline.

**DR. BYRON WILLIAMS:** And is there a reason for that?

**MR. WARD KEITH:** There is no specific reason other than we are just continuing to examine and finalize all the datasets for these programs. So this has been identified, as you have pointed out, but to my knowledge, there's not been a specific timeline put to it.

Keith, 933

# **We should recognize achievements of DSR**

CAC MB has generally been supportive of the DSR program

But did not sufficiently address its mind to the challenges related to the aggregate risk posed by the primary and secondary drivers of a vehicle and whether DSR appropriately reflected that (CMMG did)

Part of Regulatory Learning of parties

# DSR Goals

Strengthen the ability to reward the safest drivers

Encourage poor drivers to improve their driving behaviour

**Enhance the overall understanding among drivers of how their driving behaviour can affect how much they pay for auto insurance**

**Enhanced understanding of the DSR program will improve the program's capacity to successfully encourage better driving behaviour and potentially improve road safety for all Manitobans.** [emphasis added]

2011 GRA, Driver Safety Rating Program – A1.4, page 1

A behaviour modification program that may not fit as well as a revenue generating tool



**Does the current system “Enhance the overall understanding among drivers of how their driving behaviour can affect how much they pay for auto insurance”?**

MR. WARD KEITH: [...] I know there could be questions about the actuarial science behind how the premium was established for each level of the DSR scale

Keith, 927

# Negative Discrepancies Raise Concerns

MR. ROBERT WATCHMAN: Now, just in terms of negative discrepancy, in terms of current and proposed it actually begins at about the plus seven (7) level. That's where the crossover is?

MR. LUKE JOHNSTON: That's correct.

MR. ROBERT WATCHMAN: So these drivers zero through six (6) are in negative discrepancy, if I can describe that way?

MR. LUKE JOHNSTON: That's – that's true. There is a gap. Yes.

MR. ROBERT WATCHMAN: So and – but the proposal is not to address that issue?

MR. LUKE JOHNSTON: The proposal was really to focus on the demerit side of the scale. I -- I know – I know what you're saying.

Johnston, 512-514

**Is it appropriate to impose surcharges on some drivers assumed to not be bearing their full costs while excusing others?**

# Positive Discrepancies Also Raise Concerns

**MR. LUKE JOHNSTON:** There is a kind of a crossover point, which I'll – which continues really on the op – on the reverse side where the plus fifteen (15) drivers are. It appears like they would pay too much on an overall basis. However, again, this is a policy-based decision.

Johnston, 512-514

# Positive Discrepancies Also Raise Concerns

MR. ROBERT WATCHMAN: So at that minus 17 to 19 range, you can't say that it's directionally supported by the statistics?

MR. LUKE JOHNSTON: [...] We're not intended to match the – the green line, just – we're – we're trying to create, again, a policy-based line where you pay more based on the risk you present. And you can see through the red line there we're basically pick – asking for a fairly linear line up to and assumed maximum of \$3000

Johnston, 525

# Discounts and Surcharges are not Optimized

Private sector often model the vehicle and driver together using insight from who's the primary driver and the secondary driver

Johnston, 1310

The type of many private insurers use currently cannot be done by because they do not asked for the primary, secondary, or occasional operators of the vehicle and therefore, can't connect that information to the vehicle they drive

Johnston, 1312

# Discounts and Surcharges are not Optimized (continued)

So unlike the private examples that we spoke of which rate based upon risk related both to the vehicle and the primary driver, in terms of the vehicle rats, MPI does not rate risk according to who the vehicle driver is expected to be

Johnston, 1311

# The Loophole – Majority of Vehicles Registered by high DSR drivers

The majority of vehicles are registered by drivers with higher driver safety rating levels

There are more vehicles registered than there are drivers at the top end of the DSR scale.

As the DSR level declines from level Plus 15 to level Zero, the likelihood of a driver registering a vehicle falls significantly

In the demerit levels, there are about half as many vehicles as drivers.

Johnston, 1311-1312



## Risks not fully optimized

DR. BYRON WILLIAMS: [...] they are paying some portion of the risk for someone else. But that risk is not fully represented because the – the driver and the minus range is benefiting from the vehicle discount associated with the – with the registered owner; agreed?

MR. LUKE JOHNSTON: I would agree that there's a portion covered but I won't pretend that it's an opt – optimize through, anything like that.

Johnston, 1322 (emphasis added)

# Potential Challenges with DSR Level 15

**DR. BYRON WILLIAMS:** And what this suggests is that at the – for this year for DSR level 15, it's estimated there is a 94.8 percent chance that the two hundred and seventy thousand (270,000) persons in that class would be moving upward on the DSR scale if there was anywhere upward to move, agreed?

**MR. LUKE JOHNSTON:** Agreed.

Johnston, 1323

See also GRA, volume 2, figure revenue 24, page 21

# There is a lot of opportunity and a Lot of Work Related to DSR

Imperfect information

Currently not employing robust modelling tools

Loophole related to vehicle driver versus vehicle registration

# Other Loss Prevention and Road Safety Issues

Potential insurance risk to the Basic plan from ride sharing activities

Keith, 937-938

MR. WARD KEITH: [...] So work is currently underway to – to determine an appropriate model for ensuring these kinds of activities, if and when they do come to Manitoba, and that, once it is put together, would then come before this Board, because it would require rate approval under the Basic plan.

Keith, 937

# Should there be program specific measures related to Road Safety Strategy

No numeric targets first three years

Keith, 943

**MR. BYRON WILLIAMS:** [...] in the interest of accountability there would be value in having targets, measures, and outcomes beyond the continued downward trend for specific areas of priority?

**MR. WARD KEITH:** I think that for specific priority areas that that is a fair statement.

Keith, 945

## MPI unable to answer whether there are any weak spots in terms of enforcement

DR. BYRON WILLAMS: [...] are there any weak spots or areas where you'd wish for greater police force participation?

MR. WARD KEITH: I – I – I'm not sure I could answer that at this point.

Keith, 915

# Need to report on process and reviews of stakeholders committee

MR. WARD KEITH: [...] one (1) of the reasons, probably the primary reason, why we established the external stakeholder committee on loss prevention, of which your clients are members, so that we have a forum where – where our stakeholders can bring forward ideas and we can discuss them as a group, and then we can put them through the program development framework and run them through the value management process.

Keith, 926-927

## **Part III - Overall Health of the Corporation**



# Part III - Overall Health of the Corporation

Purpose of the RSR

Defining rate shock

Is there consensus on “the correct way to assess the risk of a significant drawdown”?

Implications of Monopoly Status of MPI and the Relationship between basic and extension

Perspective on the relevance of the MCT

Are there other – more important tools to protect consumers?

Regulatory Dialogue versus Ultimatums

# Recommended Findings Regarding the Purpose of RSR

The purpose of the RSR is to mitigate Rate Shock related to material, unforeseen and uncontrollable events

The purpose of the RSR is not to avoid inflationary cost increases

The purpose of the RSR not avoid necessary rate increases or surcharges

The purpose of the RSR is not effectively immunize management from imprudent actions

# You would almost think there was consensus on the purpose of the RSR

DR. BYRON WILLIAMS: Can we agree that in terms of the rate stabilization reserve an important purpose of it is to mitigate against rate shock?

MR. PETER YIEN: We can mitigate rate shock for the elements that are uncontrollable, yes.

Yien, 1075

## **You would almost think there was consensus on the purpose of the RSR (continued)**

The Corporation is confident and the evidence will show that a sufficiently funded rate stabilization reserve will ensure rate stability by protecting ratepayers against unforeseen and uncontrollable events, including interest rate fluctuation, but also hailstorms and long-tail complex injury claims, which are trending. That's what the capital is designed to do, to protect the ratepayers against these events.

Scarfone, 33

## **You would almost think there was consensus on the purpose of the RSR (continued)**

**DR. WAYNE SIMPSON:** In the RSR, which is supposed to deal with unexpected and non-recurring events to avoid rate shock.

**DR. WAYNE SIMPSON:** Of – of the – of the size of the RSR, which is supposed to deal with the possibility of adverse events which would be non-recurring.

Simpson, 1606-1607

## **RSR is not to cover avoid necessary rate increases above the Corporation's 3 percent rate shock definition**

MR. LUKE JOHNSTON: [...] So, I would not anticipate the RSR to bridge any sort of gap. If we had an AAP indication above 3 percent, if that's the question being asked. [...]

But in – in a case where the indication was 4 percent, we wouldn't say, well, don't worry about the RSR, we'll cover anything over – over 3 percent. That wouldn't be our intention.

Johnston, 1076

# RSR not there to make sure that future rates don't change

DR. BYRON WILLIAMS: [...] And what I take from that first point is that the Corporation's intent is not to draw down the RSR to cover legitimate inflationary projections; agreed?

MR. PETER YIEN: Agreed.

DR. BYRON WILLIAMS: But it does conceive of the RSR as being there in the event that there are extreme unpredictable events?

MR. PETER YIEN: That's correct.

(continued)

# RSR not there to make sure that future rates don't change (continued)

DR. BYRON WILLIAMS: And the purpose of the rate stabilization reserve is not to ensure that future rates are unchanged. So it's – it's not about making sure that future rates don't change.

MR. LUKE JOHNSTON: It's not. The – the rate indication is driven by the experience that we have and there are times where, for example, physical damage growth is more than inflation. It has to be reflected in the rate.

Yien and Johnston, 1076-1077 (emphasis added)



# But Apparently the Range Has a Different Purpose (after a lengthy delay)

DR. BYRON WILLIAMS: (reference CAC-MPI 1-87) Directing your attention to the last two (2) lines, you see a suggestion here: "to better serve the purpose of the RSR, i.e., prevention of rate increase or RSR rebuilding fees." Is it fair to say that the RSR does not exist to prevent rate increases?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Sorry for the delay. So the – the purpose of the ranges is, really, as an operating range where you could have variability and wouldn't have to issue RSR rebuilding fees or – or rebates. So RSR rebuilding fee is – is – is like a rate increase, in its – in its application, but it's not a – a rate change in the sense of AAP rates.

Johnston, 1078

# And apparently any surcharge or rebate is rate shock

MR. PETER YIEN: [...] And I re-emphasize the word 'range', because any time when we have a target, it generates rate shock, because if we have a number that we are aspiring to, take any number, once we go above it, it's rebate; once we go below it, it's rebuilding fee. So we – we guarantee a shock. And so having that right range is appropriate.

Yien, 1340-1341 (emphasis added)

# Consumers did not sign up for – double padding that is not rationally aligned to risk

RSR to defend against rate shock

But Range to defend against rate increases and surcharges?

Proposed range is actually larger than difference between lower target and zero

**Do consumers know they are signing up for this?  
Recognizing the opportunity cost and assuming  
that consumers are rational economic actors,  
why would they endorse a range this large?**

# CMMG States the Concerns of Consumers Well

MR. RAYMOND OAKES: [...] And I'd suggest that we've seen that type of ingenuity before. We've seen the interest forecast rate risk, which was trotted out last year as a opportunity to again – again pad reserves and put money aside so that their job becomes easier in providing insurance to Manitoba, but I think we get away from the concept that these are funds of Manitobans and should be returned to Manitobans, unless inadequate case can be made to retain those.

Oakes, 63

# Why would a rational consumer knowing the DCAT analysis endorse a RSR range of the magnitude proposed by MPI

Why would a rational consumer, informed by an independent evidence based process, endorse protection from “rate increases or surcharges” to protect against more than 1/2000 year event (without management action) and a far lower probability with management action?

Why would a rational consumer, informed by an independent evidence based process, endorse higher than 1/700 year floodway protection to protect against “rate increases or surcharges”?

# Recommended Findings with Regard to Rate Shock

While a 3 percent rate increase may not be affordable to many consumers, it is not an appropriate definition of rate shock for regulatory purposes

In low inflationary times, it also is not appropriate to employ the frequently used threshold of 10 percent

Considerations of the definition of rate shock should include the level of inflation, whether or not there are competitive alternatives, whether the commodity is a basic necessity and whether there are other significant cost pressures on necessities

In low inflationary times, rate shock is likely to be defined in the 5 percent to 7 percent range

# **The Definition of Rate Shock Animates the MPI Approach to the RSR and the Application**



# The MPI definition of rate shock is unusual and not analytically defensible

MR. PETER YIEN: What we do know is an average Manitoban if they see a rate increase greater than 3 percent, that's translated into a rate shock.

DR. BYRON WILLIAMS: Okay.

MR. PETER YIEN: Because they can't afford it.

Yien, 1075

See also Yien, 1072

# It is difficult to determine if the MPI definition of rate shock is tied to inflation

DR. BYRON WILLIAMS: And is that rate shock calculation of 3 percent, is that affected in any way by the relationship with inflation?

MR. PETER YIEN: Absolutely. The 3 percent is certainly defining context of current inflation. [...]

DR. BYRON WILLIAMS: Okay and just so – I see – I see that. What I'm trying to get at, sir, is let's say inflation was 1 percent. What's rate shock?

MR. PETER YIEN: In – it will be roughly 1 percent and slightly above.

DR. BYRON WILLIAMS: Okay, and if inflation was 2 percent, rate shock would be 2 percent?

MR. PETER YIEN: Okay, let me clarify this. I don't want to give an impression that rate shock is defined by inflation.

Yien, 1074-75

# Simpson Ties Rate Shock to Inflationary Expectations

DR. WAYNE SIMPSON: [...] Whereas, I would project those increases as the kinds of increases in costs you would expect of an operation, wages and other things, and the kinds of - - of increases that ratepayers would be expecting in this period. In other words, rate shock might be 5 or 6 percent or 7 percent, but it wouldn't be 1 or 2 percent given that there's been a slow increase in prices of that range, and a slow increase in salaries of - - of that range or a little bit more

Simpson, 1578

# CAC MB does not believe the MPI definition of rate shock is defensible

While CAC MB recognizes affordability concerns at 3 percent that is not the safe as rate shock

There is a difference between affordability which is tied to income and rate shock which relates to the consumers expectations and ability to adjust in an orderly fashion

In low inflationary times, it also is not appropriate to employ the frequently used threshold of 10 percent

Considerations of the definition of rate shock should include the level of inflation, whether or not their are competitive alternatives, whether the commodity is a basic necessity and whether there are other significant cost pressures on necessities

In low inflationary times, rate shock is likely to be defined in the 5 percent to 7 percent range

# Recommended Findings relating to the DCAT, MCT and Overall Health of the Corporation

There is consensus that the DCAT is the “correct” tool to assess the risk of a draw down in the RSR

In 2016, the DCAT was approved for the purpose of the RSR by an independent regulator in an evidence based process

The appropriate threshold and range of the RSR must be determined in light of the harm it is developed to address (rate shock relating to uncontrollable and unforeseen events) and the risk tolerance of those it is designed to protect taking into account their opportunity costs and its implications

# Recommended Findings relating to the DCAT, MCT and Overall Health of the Corporation

Contrary to the assertion of MPI, Extension is reliant upon and strengthened by its relationship to basic

A long term view of the Corporation demonstrates significant indicia of good health and significant opportunities to return to short term health with improved management and forecasting

Any comparison of capital levels must consider the purpose of the reserve and the process by which the reserve level was developed

Neither MPI basic or its extension adjunct face a material risk related to premium flight

The MCT targets of the SGI Auto Fund and ICBC were selected through a political process not an independent regulatory process

# Recommended Findings relating to the DCAT, MCT and Overall Health of the Corporation

The DCAT is a robust regulatory tool with opportunities for improvement related to:

- the use of the naive forecast which is not a best estimate
- ongoing challenges with the interest rate floor which is particularly challenging in a rising interest rate environment
- a need for further consideration of the implications of corporate bonds which have not been considered in any collaborative process

Care should be taken with regard to off hand comments relating to statutory interpretation and reserves under the statute



# The DCAT is the best tool to identify unforeseen, uncontrollable risks

The correct way to assess the risk of a significant drawdown in the RSR balance is by using the results of the Dynamic Capital Adequacy Test (DCAT) report. The DCAT analysis provides modeling results based on the current risks facing Basic insurance. The DCAT utilizes models for equity returns, interest rates, and claims costs that were developed based on the historical variability of these risks. The DCAT modeling was developed in collaboration with the Public Utilities Board.

Exhibit MPI - 37 (emphasis added)

Subject to certain methodological disagreements, Dr. Simpson agrees with MPI

Simpson, 1583-1584



# **A robust tool specifically related to the RSR Purpose**

**Takes into account, historical experience**

**Naturally accounts for inflation**

**Allows for reasonable management action**

**Considers correlations and risk tolerance**

**Consumers can see what type of risk being presented**

# A robust tool specifically related to the RSR Purpose

DR. WAYNE SIMPSON: Yes. And the rate stabilization reserve would be expected to go up and down, which is why there's a range – should be range.

Simpson, 1599

DR. WAYNE SIMPSON: [...] but the whole idea of risk and risk analysis is to look at both the favourable and unfavourable events around a best-case scenario. And, for example, in the case of – of equities, there are – there are probably many – there's a dramatic recovery in – in equities following 2008/2009. And there are dramatic positive events on the other side.

Simpson, 1600-1601

# Key Considerations for the Threshold and Range

RSR purpose – Rate shock – not the flood of the century – not an earthquake in BC

Risk Tolerance in Light of the RSR Purpose

Opportunity Costs for individuals and MB

Overall Health of the Corporation

# Risk Tolerance should be bounded by what we are protecting against

DR. WAYNE SIMPSON: [...] And there's an argument – some argument for a wider range, since there – an issue has been made of this that the range is too narrow by greater risk tolerance levels. Not 1:2,000, but maybe 1:500. But again, we now start to see that we're right up there with the Floodway. And the question, then is: Do ratepayers want to protect themselves as much from a catastrophic flood as they do from a – a rate shock? And I – I think the answer to that is no. I think 1:200, for example, is a reasonable level of protection.

Simpson, Page 1572, Wayne Simpson, Risk Tolerance for Ratepayers

# Capitalization Considerations must consider the purpose

DR. WAYNE SIMPSON: Not – not the same sorts of reserves because of the questions of the competitive nature of the business and bankruptcy, but they should both have adequate reserves to – to – well, in the case of MPI, the focus is really rate shock. I'm not sure that is really the focus of a private insurer.

The focus of a private insurer is – is avoidance of difficult financial circumstances which is really not rate shock. They have a different set of concerns because they – they don't control the rates set, in the sense they have to be competitive whereas MPI doesn't have that concern. So they're – they're really quite different, I think. So satisfactory in their own domains.

Simpson, 1594-1595

# The Opportunity Cost Should be Considered

**DR. WAYNE SIMPSON:** [...] the issue goes beyond the simple business interests of MPI to the broader social interests, and the reflection of the fact that there's some sort of balance to be achieved between the intr – business interests, the legitimate business interests of MPI in stabilizing rates and protecting against risks, and the value to consumers, ratepayers, of having money in their pockets to spend and invest. So that balance has to be recognized.

Simpson, 1564

# Ernst and Youngs comments make the same opportunity cost point

DR. WAYNE SIMPSON: However, from the sti – that – what I would call the balance standpoint of taking into consideration the opportunity costs, foregone of having ratepayers without the funds to spend and invest, I – I wouldn't necessarily characterize that as a bad thing. And I interpret the Ernst & Young statements to support that that position that the – a balance has to be drawn, and that perhaps the hundred percent MCT and higher levels, if – if their targets, for example, is – is excessively conservative when you weigh the two (2) – two (2) sides.

Simpson, 1615

This is a legitimate consideration in the public interest



# Implications of Monopoly Status for Basic

MPI has a legislative monopoly when it comes to basic insurance.  
Competition is statutorily prevented

Yien, 1011

“Los(s) of market share through competition does not exist. So there's no marketshare risk.”

Johnston, 1012

As a monopoly the customers of Manitoba Public Insurance have no place else to go in the event that rates are increased



# Extension enjoys a de facto monopoly due to its relation to Basic including shared platforms

There is no legislative monopoly with regard to Extension

Yien, 1013

Monopoly and competitive side of the business often work off of the same information technology platform

Yien, 1014

# **Extension enjoys a de facto monopoly due to its relation to Basic including shared platforms (continued)**

**Autopac Online service that connects MPI with brokers and, ultimately, consumers key to both the operations of Basic and Extension**

**Yien, 1014-1015**

**Claims Administration and Reporting System also a key platform for both the Basic and Extension side of the business**

**Yien, 1015**

# Seamless Transactions

Non Basic lines of business are dependent on its basic platform.

When a consumer goes into a broker's office they can have a seamless transaction in getting Basic and Extension, at the same time off the same platform

Yien 1018

# The One Screen Advantage

**THE CHAIRPERSON:** But if they're – if they're going on the computer and putting the information in, they simply – the – there isn't one (1) screen for Basic and another screen for Extension, 1 is there? It's – it's integrated in one (1) screen?

**MR. LUKE JOHNSTON:** There – there is one (1) screen. They can select the deductible level there, yes.

Johnston, 1335

# Higher Incentives Related to Extension

**MR. LUKE JOHNSTON:** The Basic commission being less than 3 percent is very, very low, so the Extension commission is higher. Yes.

Johnston, 1335

# 95 Today – 95 in 2010 – 95 in 2008

MPI's estimate for 2016 and a proxy estimate for 2008, using fiscal year data, suggests that the Extension market share was over 95% throughout this period.

Exhibit PUB - 45

In 2010 MPI 95 percent of the Extension market at that point in time with no private insurer having even a 0.5 percent share

PUB 145/10, p 6 and Yien, 1017

See also Yien 1016/17

See also Order 162/11, Yien, 1018

# Heavy Proportion of IT Costs go to Basic

AOL/CARS budget 62 million, about 11.4 million is going to non Basic - And over 50 million is going into Basic deferred development

Yien, 1015/16, Exhibit PUB 2-16

CCRS \$23 million - about \$21.5 M assigned to Basic

Yien, 1016, Exhibit PUB 2-16

# Taking one for the Team - Shared Risks but Basic Disproportionately Exposed

Both the Basic and Extension lines of business are exposed to interest rate forecasting risk

Yien 1020

Due to Corporate level asset liability/matching



# Taking one for the Team - Shared Risks but Basic Disproportionately Exposed

18/19 corporate basis, the estimated net impact of a negative 100 basis points shift is about \$21 million

Yien, 1022-1023, Exhibit PUB 1-43

For Basic, the estimated net impact of a minus 100 basis point shift is 44.7 million

Yien, 1023

Roughly twice as much

Yien, 1023

# Taking one for the Team - Shared Risks but Basic Disproportionately Exposed

20/21

DR. BYRON WILLIAMS: [...] for 2021/'22, on the corporate side we see the impact of a negative 100 basis points shift as being around 4 million, sir.

MR. PETER YIEN: Yes.

DR. BYRON WILLIAMS: And for the Basic program, the net negative impact would be 39 mil -million.

Yien, 1023-1024

# **Taking one for the Team – Moving Hail to Extension does not reduce the risk to MPI**

With regard to hail and comprehensive coverage transferring (risk) from the Basic program to the Extension program would not reduce risk for the Corporation, it would merely transfer it to another line of business

Johnston, 1032

See also Exhibit CMMG 1-5

# Extension Benefits from Basic

Extension dominates market - heavily reliant on basic for market share including seamless transaction costs

Extension benefits from common platform such as AOL/CARS with heavy portion of those costs coming from basic

Basic as compared to extension disproportionate interest rate downside risk (to benefit of corporation as a whole)

Based on conscious choice which corporation judged in best overall interest

Substantial reason to question the allegation that extension subsidizing basic

# Extension has grown very strong on the back of basic

MR. RAYMOND OAKES: The last question you may have more difficulty with. The evidence before this Board is that MPI has transferred \$27.8 million into the RSR. My question of the Corporation is how much more could they have transferred? How much is available?

(BRIEF PAUSE)

MR. PETER YIEN: If I can refer to my testimony, I believe – if I remember correctly on Wednesday, as per the financial statements last year, 2016/'17, in Extension. We had available of \$98.5 million worth of equity. And the required minimum equity is sixty-seven-point-five (67.5). If I take that difference there would be 31 million left.

Oakes, 1006

# Over the long term, the Corporation has been Strong

Both basic and extension have shown net positive income over last decade

Exhibit CAC - 20

Longer term results to 2001 support overall health

Exhibit MPI - 36

# MCT Overview

100% MCT with management action not one single scenario

Not a good fit for the RSR purpose

Saskatchewan and BC targets were not selected by an independent regulator in an evidence based process

Exhibit PUB 1-73 b

Not required SAAQ and Ontario mutual funds

## Is the risk tolerance associated with the upper limit commensurate with the purpose

DR. WAYNE SIMPSON: There were questions about just what degree of conservatism is implied, and they state that based on the DCAT modelling, the estimated probability level that will exhaust the proposed maximum upper RSR target of 438 million, which is the hundred percent MCT level, without management action is a 1:2,000, although I would say it's greater than 1:2,000, because they then go on to say the DCAT modelling did not identify any adverse scenarios with management action that exhausted the \$438 million upper target. So essentially, it's unknown, but a lower bound of 1:2,000 is placed on it with management action. And I relate this kind of conservatism, if you will, to things like the Floodway, which is a major concern about risk, as opposed to a much more minor concern with Autopac rates, and there, the – the standard is now 1:700, so quite a bit lower than - - than 1:2,000.

Simpson, 1568-1569



## Tool is not a Good Fit

**MR. MATTHEW GHIKAS:** Now, I just want to clarify your position, Ms. Sherry, on whether you oppose the use of the MCT as a test for MPI, or whether you simply believe that 100 percent MCT is too high?

**MS. ANDREA SHERRY:** My belief is that the MC – a choice of a target, a higher level of the RSR using 100 percent MCT is arbitrary. The MCT wasn't created for an RSR target per se, it was created so that OSFI would know when a company was in to the potential of going insolvent. So the tests around it including tests of a BC earthquake, et cetera, things that MPI does not face. As well, MPI does not face the risk of insolvency and the risk to the whole economy of Canada if we – they go down on. That's what OSFI is trying to protect the consumers against. It wasn't built for a monopoly public insurer.

Sherry, 1695-1696

## Tool is not a Good Fit

MR. MATTHEW GHIKAS: Okay. So let me – let me ask you this again. I'm not sure if I understood whether you are objecting to the use of the test itself, or whether you're objecting to the use of 100 percent.

MS. ANDREA SHERRY: I'm objecting to the use of the MCT as – in setting the RSR range. MR. MATTHEW GHIKAS: Okay.

MS. ANDREA SHERRY: You can calculate. the MCT and see where you're at, but it's – I – I don't think it should be used to set the RSR range.

(tortured attempt at impeachment by MPI)

**Ernst and Young also question whether it is the appropriate tool**

## Not all are bound by MCT

**MR. LUKE JOHNSTON:** Literally everybody uses this test except MPI. The one (1) possible exception would be Quebec, the SAAQ. I won't try to pronounce that properly.

Johnston, 149

In Ontario farm mutual insurers are exempt from complying with the MCT because their membership in mutual guarantee fund provides support for their capital.

Johnston, 1079-80

# The Naive Forecast is not a best estimate

The unusual nature of the recent low interest rate environment has made it difficult to evaluate interest rate forecasting quality. What seems clear from recent increases in the Bank of Canada's policy rate and corresponding increases in other interest rates, including the 10-year Government of Canada rate, is that the *ad hoc* naive forecast is very likely not the best forecast and that a return to reliance, at least partially, on the SIRF that projects the path of rising interest rates over the next four years is needed. Thus, at least a return to the 50-50 forecast used previously would seem appropriate.

As in (a), we are responding to the return to rising interest rates that has been forecast by the SIRF for several years as well as rapidly improving economic growth that should stimulate further increases in the policy and other interest rates

Exhibit PUB CAC 1-2,

See also Simpson, 1577

# The Naive Forecast for DCAT Modelling Purposes has been overtaken by events

The actual market interest rate as of September 30, 2017 is 2.10%, reflecting an increase of 0.46% from 1.64% when the 2018 GRA was filed. The change in the interest rate increased the projected duration weighted investment return of the fixed income portfolio from 3.78% to 4.15%.

Exhibit MPI - 16, PUB pre-ask 1

# A Scenario without Inflation is Unlikely to be a best estimate

DR. WAYNE SIMPSON: So in this era of kind of stable inflation and inflationary expectations, I find it odd that the base scenario assumes no increase in the third and fourth years.

Simpson, 1578

# Modelling

**DR. WAYNE SIMPSON:** There – there should be an analysis of the degree of risk associated with favourable and unfavourable events around interest rates movements, just like there are, say, with equity movements in the equity decline scenario. And recent historical experience has made that more difficult. And so what we have is what I've characterized as an ad hoc process of characterizing the – the lower floor on – on interest rate declines.

The problem with that is that as interest rates rise the scenario still drives interest rates to the floor in predicting the adverse event, which suggests that as interest rates rise interest rate risk will rise. And I would take exception to that.

Simpson, 1628-1629



# Interest Rate Floor Modelling

**MR. ROBERT WATCHMAN:** So if I understand that correctly, it's your opinion that there's less of a need for a floor now, with increased rates?

**DR. WAYNE SIMPSON:** I think so, and particularly as we go, say, forward to next year

Simpson, 1652

## **DCAT risks are probably overstated**

**DR. WAYNE SIMPSON:** So to summarize, what are the implications of interest rate and inflation assumptions? The combination of one (1) on rising interest rates, and two (2) the premium rate increases in line with forecast inflation would produce significantly higher total equity for the base scenario in 2018/'19 and beyond, essentially repeating what MPI is telling us. And I'm projecting that the higher total equity in the base scenario should significantly reduce the low RSR lower and upper thresholds in the DCAT for the same level of risk tolerance, subject to them working through the details of that.

Simpson, 1579

# Opportunities to Improve the DCAT for the Purposes of the Next GRA

The DCAT is a robust regulatory tool with opportunities for improvement related to: (indent and bullet)

The use of the naive forecast which is not a best estimate

Ongoing challenges with the interest rate floor which is particularly challenging in a rising interest rate environment

A need for further consideration of the implications of corporate bonds which have not been considered in any collaborative process

# RSR is not the only tool

Good management, good reserves and good forecasting more important tools

An excessive RSR chills accountability

Imagine trying to go in for RSR surcharge after PUB warnings about asset/liability mismatch in 2013 and 2014

## Dialogue Not Ultimatums

**MR. BYRON WILLIAMS:** And I'm just trying to understand the position of MPI. If the Public Utilities Board exercises independent professional judgment and selects a different range for the RSR than recommended by MPI, and does not accept the recommendations of MPI with regard to the treatment of cash flow related to the RSR investments, is MPI taking the position that the decision to extend the purchase of corporate bonds from 8 percent to 18 percent will be cancelled?

**MR. PETER YIEN:** That is exactly right.

Yien, 1069-1070

# **Our Client has observed a similar approach by MPI previously**

Current CEA appeared to suggest a number of years ago that transfers from extension line were contingent upon appropriate RSR level

# Our Client appreciates MPI Recanting the Ultimatum

MR. STEVE SCARFONE: Thank you. And for – and for Mr. Yien, Mr. Yien, I believe it was on Friday at the end of your cross-examination by my friend Mr. Williams, you indicated that the Corporation would require from the PUB its upper and lower requested RSR targets, or it wouldn't proceed with the corporate bond strategy. Do you recall that?

MR. PETER YIEN: I do.

MR. STEVE SCARFONE: And sir, at least from my perception, this, to me, almost sounded – it almost sounded like an ult – ultimatum. Is that the message that you wanted to convey to the Board on this – on this issue?

Yien, 1339

# Off hand statements regarding the Legislation should be treated with care

MR. STEVE SCARFONE: Were you aware, sir, that the Act that governs MPIC, the Manitoba Public Insurance Corporation Act, mandates sufficient reserves in place for the Corporation?"

Scarfone, 1595

## *MPIC ACT*

### "Reserves

18 The corporation shall establish and maintain reserves in such amounts that, at all times, it has sufficient funds to meet all the payments as may become payable under this Act and regulations."



# Off hand statements regarding the Legislation should be treated with care

On page 1617 MPI claims the government can take from MPI:

"MR. STEVE SCARFONE: And so there would be nothing based on that that would prevent the Province of Manitoba from demanding from MPIC that it redeem its investments and send the cash over to the people at Broadway?"

DR. BYRON WILLIAMS: Is My Friend asking for a legal opinion?"

Scarfone, 1617

Requires an understanding of the Interplay of Numerous Sections and we do not share the opinion of MPI

**Request right to file written submission on any legal interpretation offered by MPI**

# Part IV – Forecasts and Rate Indications

# Recommended Findings related to interest rate forecasts

The naive forecast approach is not employed by SGI, ICBC, the Province of Manitoba or Manitoba Hydro

The naive forecast was not recommended by Dr. Cleary on behalf of MPI during last year's proceeding or by Dr. Simpson or Ms Sherry in this proceeding

The naive forecast is not employed by the major banks

# Recommended Findings related to interest rate forecasts

Adoption of the naive forecast would be contrary to major economic trends as flagged by the Bank of Canada in its July 2017 Monetary Policy Report (referenced in Dr. Simpson's evidence)

This is not the right time, especially in a climate of stronger economic fundamentals and rising interest rates to adopt a naive forecast

# Recommended Findings related to interest rate forecasts

Since the Great Recession, interest rate forecasting has been particularly challenging although there appears to be growing traction for expectations of interest rate growth given Canada's economic fundamentals and statements by the Bank of Canada

Adoption of the Standard Interest Rate Forecast would be consistent with the approach taken with regard to Manitoba Hydro currently and with prior decisions made by the Board

Dr. Simpson and Ms. Sherry have recommended moving to at least the 50/50 approach for the purposes of DCAT modeling

# Province of Manitoba does not employ naive forecast

MS. KATRINE DILAY: And it be fair to say that pri – provision was made in the 2017 budget for an upward movement of interest rates, correct?

MR. GARRY STESKI: That is correct.

Steski, 1424,

# SGI uses Conference Board Forecasts

**DR. BYRON WILLIAMS:** And sir, are you in a position to comment on whether or not Saskatchewan Government Insurance, for its forecasts, uses the Conference Board of Canada forecasts, sir?

**MR. LUKE JOHNSTON:** My understanding is— SGI uses Conference Board, and they've basically have the same consequences as us for using that forecast, being that it was assumed to — to rise.

Johnston, 1328



# No Suggestion that ICBC uses Naive Forecast

**DR. BYRON WILLIAMS:** And ICBC, sir, are you in a position to confirm whether or not they use a version of the standard interest rate forecast?

**MR. LUKE JOHNSTON:** I'm not as – I can't recall what ICBC uses. Sorry.

**DR. BYRON WILLIAMS:** You're not suggesting that they use a static or naive forecast, though, sir?

**MR. LUKE JOHNSTON:** No, not suggesting that, just saying that I don't know.

Johnston, 1328

# Would anyone endorse a naive forecast for Hydro?

Consideration should be given to a standard regulatory approach for all crowns

# Cleary did not select the naive forecast

DR. BYRON WILLIAMS: And sir, you'll agree that in terms of professor Cleary's recommendation for interest rates, he ultimately recommended 50/50? Do you recall that, sir?

MR. LUKE JOHNSTON: I do.

Johnston, 1327

# Should not be going the wrong direction at the wrong time

DR. WAYNE SIMPSON: [...] So my comment at least 50/50 sort of reflects the fact that we shouldn't be going in the wrong direction at exactly the wrong time.

Simpson, 1659

# Simpson and Sherry reject the Naive Forecast and Recommend at least the 50/50 for the DCAT

The unusual nature of the recent low interest rate environment has made it difficult to evaluate interest rate forecasting quality. What seems clear from recent increases in the Bank of Canada's policy rate and corresponding increases in other interest rates, including the 10-year Government of Canada rate, is that the *ad hoc* naive forecast is very likely not the best forecast and that a return to reliance, at least partially, on the SIRF that projects the path of rising interest rates over the next four years is needed. Thus, at least a return to the 50-50 forecast used previously would seem appropriate.

As in (a), we are responding to the return to rising interest rates that has been forecast by the SIRF for several years as well as rapidly improving economic growth that should stimulate further increases in the policy and other interest rates.

The naive forecast should not be used for rate setting or target capital purposes.

# So why at least 50/50 for Simpson rather than SIRF

In the context of DCAT, Dr. Simpson sees his recommendation as a compromise flowing from prior discussions

THE CHAIRPERSON:[...] know more about it than me but I guess the question is: Given how flat interest rates were last year and you thought SIRF was the standard for last year, I'm wondering why you think 50/50, at least, is the standard for this year when interest rates are going up. I would have thought you would have gone immediately to SIRF?

DR. WAYNE SIMPSON: Well, I said at least 50/50 because we'd kind of reached agreement last year that the 50/50 was a compromise. I said – I said, and probably some of this had to do with – with when it happened, but, I said that we were trying to out guess the banks, and I had some trouble with that. And I still have some trouble with that.

Simpson, 1659 (emphasis added)

# Economy and Bank of Canada drive greater confidence in rising rates

DR. WAYNE SIMPSON: [...] you know, quite significant events are happening, in terms of interest rates. And, in particular, over the summer, the movements by the Bank of Canada and the – the news' reports on the growth of the Canadian economy have change people's opinions about – at least changed my opinions about the where interest rates are going.

And I'm more inclined now towards the SIRF than I was before, and less inclined certainly towards the naive forecast. So as – as those weights shift, when I say, "at least the 50/50," I don't discount the possibility that – that we should pay more serious attention to the SIRF as well, given where interest rates have gone over the last four (4) months.

Simpson, 1648



# Policy Rate and Long Canada Rate both respond to inflation and growth

MR. STEVE SCARFONE: Yes. And that there is little if any connection to the overnight rate that – that drives interest rates for the major banks; correct?

DR. WAYNE SIMPSON: Oh, I don't agree with that at all. The – the term structure of interest rates is – is largely driven by the policy rate unless there are intervening factors. But I – I don't see anything that would not cause interest rates to rise reasonably uniformly with the overnighter policy rate.

Simpson, 1634

MR. STEVE SCARFONE: Well, would you agree with me, sir, that the long-term interest rates are mostly driven by real economic growth and inflation?

DR. WAYNE SIMPSON: They are, but that is what the policy rate is also reacting to.

Simpson, 1634



# The Bank of Canada Monetary Policy Report is reasonably aligned with the Standard Interest Rate Forecast

BoC projects a rising policy rate from the current 1% (only 0.75% then) to 2.5-3.5%, or a further rise of 1.5-2.5% by 2019.

BoC Monetary Policy Report (July), p.7, referenced at Simpson, 1628

This SIRF was before the two BoC policy rate increases, so it may understate where the SIRF would now see the 10 year GoC rate going

# Forecasting Short Snappers

## PIPP

Bring external to look at Reserves

Get long tailed data Quebec

## Comprehensive

importance of testing for impacts related to climate change and potential mechanisms to do so

Simpson, 1666

# Recommended Findings relating to the inclusion of investment income from the RSR in the Rate Indication

Most consistent with regulatory principle of intergenerational equity

Consistent with accepted actuarial practice and commonly employed

Consistent with our understanding of how inflation is built into estimates of claims design, revenue requirement and DCAT

# Intergenerational Equity

MS. ANDREA SHERRY: Well, its investment – its investment income that has been collected from prior policyholders – or on the RSR that has been collected from prior policyholders. So my point there is that since MPI is a monopoly, the current policyholders were most likely policyholders - - or most likely will be next year, and were the year before, and last, et cetera. You have a fairly – fairly stable book of policyholders.

Sherry, 1723-1724

MS. ANDREA SHERRY: I don't think so. I think it is only partially true. I think you've got the same policyholders. So the RSR is built up over the same policyholders that have been there for years. And so that – that revenue is related to them, and to the people that will have policies in 2018/'19.

Sherry, 1725

# Recommended Findings Relating to the Inclusion of Investment Income Related to the RSR into the calculation of the rate indication

MS. ANDREA SHERRY: When you do a rate indication you always look at the capital backing the book of business it's been priced for. And you take into consideration the return on investment on that capital. So to me it should be done here as well, for that reason as well as other reasons.

Sherry, 1734

Investment income would come in by virtue of the first part of the standard, the present value of cash flows relating to the revenue at the indicated rate.

Sherry, 1734-1735

# Based upon forecasted total equity 2018/19

MS. ANDREA SHERRY: Because the targets, or the lower and upper targets for the RSR is being still discussed I would suggest that the forecasted 2018/'19 total equity would probably be a more stable figure to use. But I did not express that opinion in the paper.

Sherry, 1739

## Both MPI and Ms. Sherry express reluctance to endorse capital maintenance provision for RSR

MS. ANDREA SHERRY: I believe it could be. I don't believe it should be. [...]

MS. ANDREA SHERRY: . . .when the PUB determines what the target RSR range should be set based on, and whether it's a range of the DCAT or the 1:40 and the 100 percent MCT, whatever that range is, then I think as long as the company operates within that range then we don't need to throw on top of that any sort of maintenance provision. It's – if you – you will manage within that range, and if you fall below the lower level of the range, then you have an RSR rebuilding whatever it is, 2 percent, to get you back into it.

Sherry, 1743

## **Both MPI and Ms. Sherry express reluctance to endorse capital maintenance provision for RSR**

**MR. LUKE JOHNSTON:** I would expect use of a capital maintenance fee to actually create more rate volatility.

Johnston, 1495



# Natural growth is built in

**MR. BYRON WILLIAMS:** Would it be fair to say that unbiased forecast – an unbiased forecasting process takes into account inflationary impacts on both revenues and costs?

**MS. ANDREA SHERRY:** Yes.

**MR. BYRON WILLIAMS:** And assuming a well-run business with unbiased forecasting, would we expect positive variances as well as negative variances from forecasts?

**MS. ANDREA SHERRY:** Of course.

**MR. BYRON WILLIAMS:** And over time, the level of both positive variances and negative variances should refer – reflect inflationary pressures assuming unbiased forecasting?

**MS. ANDREA SHERRY:** Yes.

Sherry, 1746-1747

## Much Ado about nothing

**MR. STEVE SCARFONE:** And you're also aware, sir, that the Corporation would like to grow the rate stabilization reserve use - - using investment income from the reserve itself; correct?

**DR. WAYNE SIMPSON:** I hope that that's what they would do with the money, yes.

Simpson, 1592

Question was not one Dr. Simpson had opined upon or been qualified for was not presented in the context of commenting upon in accordance with actuarial principles was not couched in regulatory principles answered as a citizen

# Part V – Summary of Recommendations