

**Actuarially Indicated Rates for MPI –
Investment Return on RSR**

**Manitoba Public Insurance
2018/19 GRA**

**Consumers' Association of Canada (Manitoba)
Submitted by the Public Interest Law Centre
Authored by Ms Andrea Sherry**

September 18, 2017

Actuarially Indicated Rates for MPI – Investment Return on RSR

With this year's General Rate Application (GRA), the Corporation has made a significant improvement to its rate indication methodology by basing it on ratemaking in accordance with Accepted Actuarial Practice in Canada (AAP). In prior years, the Corporation had determined its rate requirement based on what rate change would result in a break even Net Income position for the proposed rating year and the year following.

AAP rate indications project the costs associated with the policies that are expected to be in place in the rating year in question and calculate what premium would be required to cover all of those costs. In contrast to calculating a rate requirement based on break even Net Income over two future years, it is projecting only the rating year in question.

Although the proposed rate indication methodology is improved, it has a significant flaw in the calculation. The calculation includes a 0% profit provision, which in effect allows the expected return on the investment assets supporting Total Equity to be available to grow the Rate Stabilization Reserve ("RSR"). The investment income on the RSR should be accounted for in the rate indication calculation which is consistent with actuarial practice generally and as it is applied to other crown insurers such as SGI and ICBC.

The arguments for the inclusion of the investment income on the RSR in the rate indication are outlined below.

1. Actuarial Best Practice

Section 2620.01 of the Standards of Practice of the Canadian Institute of Actuaries states:

"The best estimate present value of cash flows relating to the revenue at the indicated rate should equal the best estimate present value of cash flows relating to the corresponding claim costs and expense costs, plus the present value of a provision for profit, over a specified period of time."

The investment income on the assets supporting total equity is a cash flow to the Corporation and should be included in the cash flows used to determine the rate indication as per the Standards quoted above.

Related to this point, the Corporation has stated as one of the reasons for not including investment income on total equity in the AAP rate indication is that the expected investment income is not yet earned. This would be true of any projected cash flow used in a rate indication so this point is irrelevant. The risk of any projected cash flow

used in the rate indication not becoming a reality should be accounted for in the DCAT/RSR determination itself, not as a modification of the rate request.

The Corporation concedes that the investment income earned on the RSR is revenue but argues that this revenue is not related to policies issued in the 2018/19 policy year. This is only partially true. If the RSR is comprised of premiums paid in prior years then some of the policyholders who contributed to it are going to have policies in the 2018/19 policy year. This discussion is continued below with the 2nd point.

2. Intergenerational Equity

The money held in the RSR today has been built up over the years by policyholders that are either still going to be insured by MPI in the 2018/19 rating year or are not because of relocation, death or other reasons. Those policyholders that have purchased insurance from MPI for years and will continue to purchase insurance from MPI have contributed to the RSR balance. The investment income on the RSR should be included in the rate indication so that the investment income related to the RSR does not become further removed from the policyholders who contributed the funds on which the investment income is being made.

The Corporation is a Crown Corporation, responsible to the people of Manitoba. The longer that the investment income on the RSR is kept in the RSR the further removed it becomes from those who contributed those funds. This leads to intergenerational inequity. Those that have contributed to but are no longer part of the system will never benefit from the investment income.

MPI responds to PUB 2-27 that “Although the calculated RSR operating range would be adequate, the lack of natural growth in the RSR balance would prevent the RSR from ever approaching the upper RSR target (the RSR upper target would presumably continue to grow over time, while the actual RSR balance would not grow). As a result, there would be a higher frequency of rebuilding fees from this approach compared to an approach that does not use RSR investment income in the calculation of rates.” The issue with this response is that it does not recognize that the actual rates paid by policyholders would, in fact, be higher for policyholders until that time that RSR rebuilding fees are needed. It is also important to note that a well-managed insurance company’s capital will naturally replenish and draw down over time.

In response to PUB 2-10 the Corporation states that “When the total equity balance is between the lower and upper targets, no ask of ratepayers is contemplated, either rebates, or surcharges.” and “If at some point in the future, the total equity balance exceeds the upper RSR target, and a rebate is issued, those policy holders will be beneficiaries to a ‘windfall’ at that time.” What these responses fail to recognize is that policyholders will pay more in rates because the rate indications will be higher because the investment income on the RSR is not included in the rate indication. Allowing the

investment income on the RSR to be included in the rate indication allows policyholders to pay less sooner and is consistent with actuarial practice.

3. Confusion between using investment income from the RSR and an RSR rebate

The Corporation has stated that “Using the investment income from the RSR to reduce the applied for break-even rates is equivalent to issuing an RSR rebate to customers.” This is not the case. The investment income earned on the RSR balance is, just that, investment income. It should be taken into account when calculating the breakeven rate indication as a projected cash flow, as argued in point 1 above.

The Corporation states that “Investment income earned on the RSR balance is to support the RSR itself as means of natural growth.” If the investment income was allowed to grow in the RSR it would increase the RSR balance further above the level required to “to protect motorists from rate increases that would otherwise have been necessary due to unexpected variances from forecasted results and due to events and losses arising from non-recurring events or factors”, which is the stated purpose of the RSR. Using the investment income from the RSR to reduce the applied for break-even rate would be a means to contain the intergenerational inequity in the rates.

In response to CAC 2-3 the Corporation states that “break even rates that are reduced by investment income on the RSR, sets a price such that policies are being sold at a loss. This loss is funded by Basic’s total equity (the RSR) and is tantamount to rebating total equity from the RSR.” The investment income on the RSR is not approved as part of the RSR so is therefore not a rebate but is projected earned investment income that should be part of the cash flows attributed to the projected rating year.

4. Including Investment Income is the public auto insurance norm

From the response to PUB 2-10: “MPI’s understanding is that the rating approaches used by both Saskatchewan Government Insurance (SGI) and the Insurance Corporation of British Columbia (ICBC) include the New Money Rate and the Return on Total Equity in their rate calculations.”

Recommendation

Investment Income on Total Equity should be included in the calculation of the Corporation’s rate indication calculation. This should be done using the methodology discussed through the collaborative process and last year’s GRA review process. This methodology is to determine a profit provision, adapted to Basic’s break-even objective, estimated as IR / PSR , where IR is the expected before-tax investment return rate on investment assets supporting Basic Total Equity, and PSR is the expected Basic premium-to-surplus ratio.

The following information is based on the response to PUB 2-11. If the PSR is based on the Total Equity 'Mid-Way' Target the indicated rate increase is 1.1%, which is a decrease of 1.6% from the applied for indicated rate increase of 2.7%. If the PSR is based on the forecasted 2018/19 Total Equity of \$205 million, instead of the Total Equity 'Mid-Way' Target of \$310 million the indicated rate increase would be 1.6% instead of the applied for indicated rate increase of 2.7%.

Appendix A:

Statement of Qualification and Duties – Ms. Andrea Sherry

Qualifications

Andrea Sherry received her Bachelor of Commerce (Honors) in December 1990 from the University of Manitoba with a major in Actuarial mathematics. She became a Fellow of the Casualty Actuarial Society and Fellow of the Canadian Institute of Actuaries in 2000. She became a Fellow Chartered Insurance Professional and received her Canadian Risk Management designation in 2005. She became a Certified Management Accountant in 2008 and is now a Chartered Professional Accountant, Certified Management Accountant. Andrea Sherry is currently Vice President, Insurance Solutions at The Wawanesa Mutual Insurance Company in Winnipeg. In her current role, she is responsible for the company's actuarial pricing, product development and maintenance, as well as head office personal lines underwriting. Prior roles include work in solvency and capital, enterprise risk management and investments. She has had appointed actuary and valuation actuary roles prior to joining Wawanesa. She has worked on Dynamic Capital Adequacy Testing and internal models to satisfy the regulatory requirements in the United Kingdom (where internal models to determine capital adequacy are used by larger companies). She has also been involved in the preparation of an Own Risk Solvency Assessment.

Andrea has worked in the Property & Casualty insurance industry for over 25 years and will rely on all of the expertise she has gained, with particular emphasis on her expertise in actuarial work and investments.

Ms Sherry's curriculum vitae was filed with the Manitoba Branch of the Consumers' Association of Canada's application to intervene in this proceeding.

Duties

The following duties were assigned to Ms. Sherry in the MPI General Rate Application.

The Public Interest Law Centre retained Ms. Sherry's services to assist the Manitoba Branch of the Consumers' Association of Canada with its participation in the Public Utilities Board review of MPI's Application on issues related to actuarial ratemaking.

Ms. Sherry's duties include:

- Attending and preparing for the Technical Workshops;
- Conducting preliminary DCAT and actuarial ratemaking work;

- Reviewing the General Rate Application in its entirety;
- Preparing first round of Information Requests;
- Reviewing first round Information Requests responses;
- Preparing second round of Information Requests and memo;
- Preparing written evidence; and
- Preparing for and attending the hearing.

Ms. Sherry's retainer letter includes that she is to provide evidence that:

- is fair, objective and non-partisan;
- is related only to matters that are within her area of expertise; and
- to provide such additional assistance as the Public Utilities Board may reasonably require to determine an issue.