Undertaking #15

Reference:
PUB (MPI) 2-11

The Corporation to confirm whether line items 22 and 23, investment fees paid and pension expense, are appropriately charged to the investment income on assets supporting total equity.

RESPONSE:

In respect of pension expense, using 100% of the pension expense in calculating the investment return on assets supporting Basic Total Equity is appropriate. The investment return is calculated using a denominator (i.e. a base) that includes all pension liabilities.

In respect of investment fees paid, MPI agrees that the investment fees should have been separated into fees paid to manage the fixed income portfolio and fees paid to manage equities. Only the fees paid to manage equities should have been included in the calculation performed in *PUB (MPI) 2-11*. Per *Volume II, Investments, page 9*, the investment fees paid for 2018/19 is $5,887,000, of which $3,885,000 represent fees paid to manage equities.

The table below provides an update to the response to *PUB (MPI) 2-11*, using $3,885,000 for investment fees paid.

Figure 1: 2018/19 Investment Return on Assets Supporting Basic Total Equity

Line No.	Description	Source/Formula	2017/18	2018/19
1	(1) Liabilities excluding 'Unearned Premium and Fees' and 'Provision for Unpaid Claims'	*Volume II Pro Formas, page 6*	361,830	377,079
2	(2) Total Equity	*Volume II Pro Formas, page 6*	220,128	204,726
3	(3) Total	=(1) + (2)	581,958	581,805
4	(4) Average (assumed as the basis for 2018/19 investment income earned)	=Average of (3)		581,882
5	(5) Investment income excluding such from the fixed income portfolio [a, b]	*Volume II Investments, page 9*		29,802
6	(6) Investment return on assets supporting Basic Total Equity	=(5) / (4)		5.12%
7	Notes:			
8	[a] Excludes interest income or gains/losses from cash/short term investments, marketable bonds and MUSH; excludes			
9	amortization of bond premium/discount; Basic's portion is 83.96%.			
10	[b] Assumed as the investment income earned on total liabilities and equity per (4) above.			

Figure 2: 2018/19 Profit Provision

Line No.	Description	Source/Formula	Amount
1	(1) Investment return on assets supporting Basic Total Equity, IR	Figure 1	5.12%
2	METHOD 1: Based on 2018/19 Total Equity 'Mid-Way' Target		
3	(2) 2018/19 Basic Written Premium	*Volume II Pro Formas, page 5*	1,083,113
4	(3) 2018/19 Total Equity Lower Target	*Volume II Pro Formas, page 7*	181,000
5	(4) 2018/19 Total Equity Upper Target	*Volume II Pro Formas, page 7*	438,000
6	(5) 2018/19 Total Equity 'Mid-Way' Target	=[(3) + (4)] / 2	309,500
7	(6) Premium to Surplus Ratio, PSR	=(2) / (5)	3.4996
8	(7) Profit Provision, -IR/PSR	=-(1) / (6)	-1.46%
9	METHOD 2: Based on 2018/19 Total Equity		
10	(8) 2018/19 Total Equity	*Volume II Pro Formas, page 7*	204,726
11	(9) Premium to Surplus Ratio, PSR	=(2) / (8)	5.2905
12	(10) Profit Provision, -IR/PSR	=-(1) / (9)	-0.97%

Based on the profit provision of -1.46% and -0.97%, the indicated rate increase is 1.00% and 1.55% respectively. As compared with PUB (MPI) 2-11, the impact of the revisions identified in this response, have a minimal impact (0.1% or less) on the rate indication using this approach.

With respect this approach, MPI wishes to re-iterate the significance of a negative profit provision. Policies will be priced to below the best estimate of costs to provide those policies. A systematic deficiency in break-even rates, such as that proposed under Method 2, would prevent the Rate Stabilization Reserve (RSR) total equity from replenishing, and as the business grows, the MCT ratio for Basic would decline.

The systematic deficiency in break-even rates as proposed in method 1 (using the “mid-way” point of the RSR) would actually cause the total equity balance in the RSR to **decline** as the profit provision is based on a total equity balance that MPI **does not have**. Method 1 asks MPI to assume Basic has total equity of nearly $310 million, and to estimate an investment income (and a negative profit provision) on that basis. Basic does not have $310 million in total equity.

MPI regards either approach to a negative profit provision as inappropriate given that: (a) Basic is thinly capitalized and in a position of unsatisfactory financial condition, and (b) the RSR framework does not contain capital rebuild or maintenance provisions. Capital maintenance and rebuild provisions are used by Saskatchewan Government Insurance (SGI) as a means to offset the unfavourable impact on capital of applying the income on total equity to reduce rates. In actuarial terms, (for the purposes of the Standards of Practice) the maintenance and build provisions are “profit provisions”. In the current context, doing what SGI does would drive up the rate request, not reduce it.