2019 General Rate Application
Closing Submissions

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Introduction

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The 2019 General Rate Application

- 2019 GRA sets tone for openness and transparency
- MPI applying industry best practice to all facets of its business
- This year's Application seeks (as at February 28, 2018):
  - 0.1% rate increase
  - 2.1% rate increase for Net Capital Maintenance Provision (CMP)
  - Rate Stabilization Reserve (RSR) Targets:
    - Upper = $305m (85% MCT)
    - Lower = $143m (34% MCT)*
  - Naïve interest rate forecast
  - 2018/2019 VFH rates based on current methodology
  - Final approval of 2017/2018 and 2018/2019 VFH rates

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The 2019 General Rate Application

- Updated figures (as at September 30, 2018)
  - 0.26% decrease in rates
  - 1.80% increase in rates for a Net Capital Maintenance Provision
  - Rate Stabilization Reserve (RSR) Targets:
    - Upper = $315m (88% MCT)
    - Lower = $140m (34% MCT)
  - Naïve interest rate forecast (GoC 10-year bond yield)

Key Speaking Points

1. Just and Reasonable Rates

2. Net Capital Maintenance Provision (CMP)
   - ❑ greater stability, predictability and less volatility
   - ❑ MPI's approach is accurate and fair

3. Rate Stabilization Reserve (RSR)
   - ❑ targets set using collaborative DCAT approach
   - ❑ targets based on best estimates
   - ❑ Prudent fiscal management demands adequate capital

Key Speaking Points

4. Interest Rate Forecasting
   - best estimate for rate setting is current GoC 10-year bond yield
   - MPI has lost more than $163m using SIRF, over estimates
   - 50/50 is not a compromise, it is biased and inaccurate
   - BoC overnight rate is no proxy for GoC 10-year bond yield

5. Investments
   - MPI moves from a comingled to segregated portfolios
   - investment decisions were made by Government-appointed experts and informed by results of an independent study
   - Basic Portfolio + low capitalization + historic losses = no appetite for risk
   - Change in risk profile of Basic reduced amount required in RSR

Key Speaking Points

6. Revenues, Expenses and Ratemaking
   - ❑no significant changes proposed this year
   - ❑expenses do not factor into this rate increase
   - ❑MPI has improved its handling of long-term PIPP claims

7. Information Technology
   - ❑new IT Strategy – focus on core business of insurance
   - ❑value management ensures accountability for IT Projects
   - ❑mistakes made, learned lessons, solid plan to move forward
   - ❑MPI meets with or exceeds performance of its peers

Key Speaking Points

8. Vehicles for Hire (VFH)
   - ❑Final approval of 2017/2018 and 2018/2019 rates
   - ❑Approval of 2019/2020 rates

9. Ongoing Topics
   - ❑Driver Safety Rating (DSR)
   - ❑Service Fees

Just and Reasonable Rates

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Just and Reasonable Rates

- First GRA under new statutory framework
  - *The Manitoba Public Insurance Corporation Act* (MPIC Act)
  - *The Crown Corporations Governance and Accountability Act* (CCG Act)

- CCG and MPIC Acts define roles for MPI and its Board of Directors
  1. establishing & maintaining reserves (s. 18 MPIC Act)
  2. make and introduce new rates and changes (s. 25(1) CCG Act)

- CCG Act defines role of PUB (s. 25(1) CCG Act)
  1. review applications for new rates/changes to existing rates
  2. approve just and reasonable rates

Just and Reasonable Rates

- Roles of MPI and the PUB under s. 25(1) of the CCG Act:

  "25(1) Despite any other Act or law, rates for services provided by Manitoba Hydro and the Manitoba Public Insurance Corporation shall be reviewed by The Public Utilities Board under The Public Utilities Board Act and *no change in rates* for services shall be made and *no new rates* for services shall be introduced without the approval of The Public Utilities Board."

- MPI and PUB have distinct <u>but</u> complementary roles to play to ensure success of Basic compulsory insurance

Just and Reasonable Rates

- What makes rates just and reasonable?
  - CCG Act, s. 25(4) provides list of suggested considerations
  - balance the impacts of rate increases on consumers with the fiscal health of the Utility
  - lowest rates are not always just and reasonable
  - must also consider impact of unstable rates “rate shock”
- MPI makes rates that it considers to be just and reasonable
  - GRA balances interests of ratepayers with MPI’s requirement to cover cost of 2019/2020 policies
- This is where interveners fall short – positions do not strike a balance, recommendations focus only on reducing rates

Just and Reasonable Rates

- CCGA requires MPI to prepare an **Annual Business Plan**
  - is approved by Minister Responsible for MPI
  - is a roadmap for achievement of Mission Statement objectives

- MPI's new Mission Statement is:

"Exceptional coverage and service, affordable rates and safer roads through public automobile insurance."

- Direction set by MPI Board of Directors, approved by Government

Just and Reasonable Rates

- Key priorities of MPI as defined by the Annual Business Plan
  1. make Basic self-sustaining
  2. establish rates in accordance with Accepted Actuarial Practice
  3. keep Basic rates stable, predictable, affordable
  4. evolve products and services to meet needs of Manitobans
  5. do not impair Consolidated Financial Statements of Manitoba
  6. capital projects/IT initiatives support core business functions
  7. continue to demonstrate fiscal prudence

- Business Plan = Industry Best Practice = just and reasonable rates

Net Capital Maintenance Provision

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Net Capital Maintenance Provision

- What is a CMP?
  - Additional amount collected from ratepayers to maintain the capital level of Basic in the a particular fiscal year
  - Treated separately by MPI from the breakeven rate indication
  - MPI considers what is needed after factoring in income earned on RSR investments (Net CMP)

- MPI's CMP Proposal – change in rate indication

  +3.3% (to maintain capital in 2019/2020)
  -1.2% (interest earned on RSR investments)
  +2.1% (NET CMP)

- Based on September 30, 2018 GoC 10-year Bond Yields, NET CMP is +1.8%

Net Capital Maintenance Provision

- Need for a CMP
  - PUB Order 130/17, Page 29:

    "The Board appreciates the need to protect Basic's capital position against depletion due to the natural growth in Basic's risk profile, i.e., the expectation for Basic claim liabilities (and investment portfolio) to grow over time since the addition of new claims is expected to outpace the settlement and closing of old claims. <u>The Board believes a properly constituted Capital Maintenance Provision, loosely based on that developed by Saskatchewan Auto Fund, can legitimately be considered as a necessary Basic expense cash flow for rate-setting purposes while remaining consistent with the break-even objective."</u> (emphasis added)

Net Capital Maintenance Provision

- Ms. Sherry testified that, in her opinion, MPI does not need a CMP
  - said if MPI holds capital within the RSR Range, it is adequately capitalized
  - said if MPI needs capital, it can seek rate increases
  - incorrectly claimed that CMP builds RSR capital until it exceeds upper target

- This ignores purpose of RSR, to prevent "rate shock"

Net Capital Maintenance Provision

- MPI's approach: a CMP that is **accurate** and **fair**
  - Accurate
    i. determines the capital required to maintain Basic in rating year
  - Fair
    i. policy holders end the year with Basic having same capitalization as it did at the start of the year
    ii. policy holders in this year are the ones who pay for the capital maintenance requirements of that year

Net Capital Maintenance Provision

- SGI's approach:
    - More complex
        - 5 year forecast (versus 1 year forecast MPI)
    - Less fair
        - Ratepayers not paying the full cost to maintain capital in that year
        - Growth in business is not static
            - Need to protect capital this year, for this year's growth
    - Limited sensitivity to changes in risk profile in the test year
        - Risk profile can change in the 5 year outlook

Rate Stabilization Reserve

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Rate Stabilization Reserve

- Dynamic Capital Adequacy Test (DCAT) establishes RSR targets
  - RSR Targets reflect results of collaborative process
  - MPI is not asking PUB to replace DCAT with MCT
  - DCAT produces a dollar value for each target which MPI then expresses as an MCT ratio
  - converting DCAT monetary targets to MCT ratios allows MPI to forecast them
  - MCT is simple, objective and works

- RSR targets must be based on best estimates
  - lower target must be minimum for satisfactory financial condition
    - improper to assume transfers from Extension
  - Current approach of PUB not based on best estimate, sets RSR lower target too low

Rate Stabilization Reserve

- Basic remains most thinly capitalized insurer in Canada
  - RSR Range remains below levels of peers
  - if MPI were a private insurer, it would be insolvent
- MPI does not seek a 100% MCT upper RSR target and does not ask to be treated like a private insurer
- MPI seeks RSR targets to ensure that it is adequately capitalized
- This is prudent fiscal management

Interest Rate Forecasting

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Interest Rate Forecasting

- Important Terminology to Consider:
  - **<u>Interest Rate Forecasting</u>** - predicting what **the Government of Canada 10-year bond yield** will be at a particular point in time
  - It is **<u>NOT</u>** a prediction of what the Bank of Canada's Overnight lending rate will be
  - They are NOT interchangeable

Interest Rate Forecasting

- Lessons learned:

- **Forecasting interest rates is hard**
  - impossible to do it accurately, bound to get it wrong
  - considering economic factors does not improve accuracy
  - the 2008 Great Recession has made it even more difficult

"22 MR. ANTHONY GUERRA: I see. Dr.
23 Simpson, do you know what the interest rates are going
24 to be on September 1st, 2019?

25 DR. WAYNE SIMPSON: No." (T: 1244)

- **Pricing Risk: Future ratepayers pay if forecasts are wrong**
  - MPI $163m less in premiums than it should have
  - Losses depleted the RSR
  - Impacts rate stability, predictability and volatility
  - Makes Basic less self-sufficient

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Interest Rate Forecasting

- Forecasting Options:
  - Standard Interest Rate Forecast (SIRF) – i.e. speculation
  - 50/50 Interest Rate Forecast – i.e. compromised speculation
  - Naïve Interest Rate Forecast – i.e. going with what is known

- Impacts or has an influence on
  - how much MPI needs to collect from ratepayers to breakeven
  - the targets to be set for the RSR

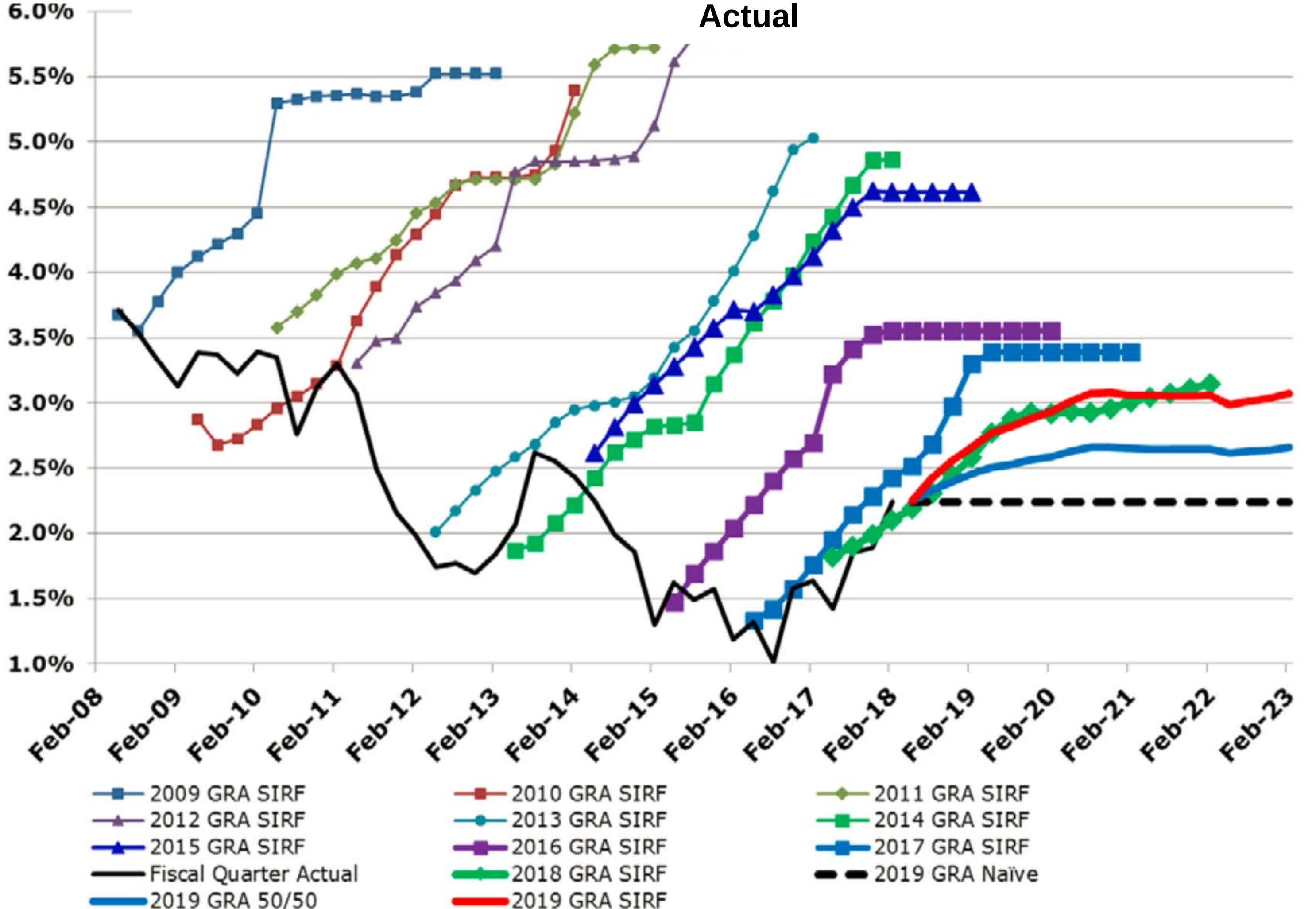
Interest Rate Forecasting

- Standard Interest Rate Forecast (SIRF)
  - uses forecasts of major banks
  - mean reversion model – considers economic factors
  - has a history of being biased and wrong

- 50/50 Interest Rate Forecast
  - weights results of SIRF against Naïve forecasts
  - attempt to improve forecasting through (judgmental) compromise
  - only half as accurate as Naïve
  - recent history suggest worse than SIRF

Interest Rate Forecasting

Figure INV- 10: GoC 10 Year Forecasted Rates from 2009 to 2019 GRA and Actual



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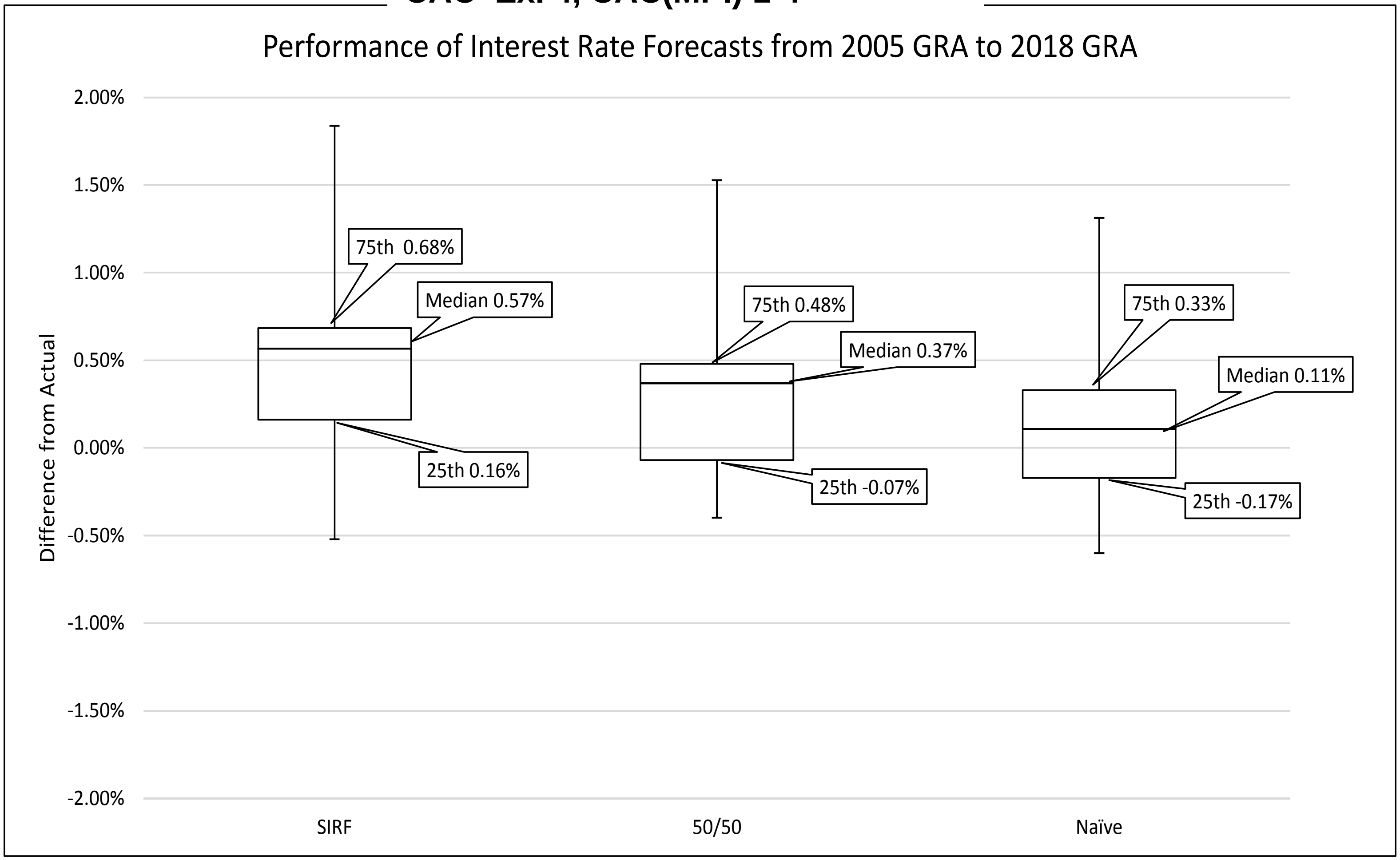
Interest Rate Forecasting

CAC Ex. 4, CAC(MPI) 1-4



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Interest Rate Forecasting

- Naïve Interest Rate Forecast
  - takes the current actual interest rate, assumes no change
  - forecast period – short vs. long term
    - Short Term: Naïve is least biased, more accurate
    - Long Term: Not relevant to ratemaking or DCAT

- Perhaps the terminology has caused confusion about what MPI is proposing

“10 THE CHAIRPERSON: Okay. What is the
11 upside or downside if instead of going -- we're going
12 to go naive or 50/50 or SIRF, that we just pick an
13 interest rate of a specific point now and say that's
14 the rate we're going to put into our projections,
15 we'll be back here a year from now and we'll see
16 whether we need to raise rates or lower rates to take
17 into account the rate we selected.” (Transcript Page. 1332)

“4 DR. WAYNE SIMPSON: That is the naive
5 forecast.” (T: 1333)

Interest Rate Forecasting

- MPI forecasts to September 1, 2019 – shortening forecast period improves accuracy and limits risk – options are:
  - use February 28, 2018 rate in GRA (18 months)
  - use September 30, 2018 rate (11 months)
  - use rate closest to rating period (compliance filing)

Interest Rate Forecasting

- Government of Canada (GoC) 10-year Bond Yields
  - MPI uses this to forecast new money yield
  - NOT the Bank of Canada's (BoC) Overnight Rate

- No meaningful link between GoC 10-Year Bond Yield and BoC Overnight Rate in short term (12-18 months)
  - short term is important for ratemaking purposes
  - sometimes BoC Overnight Rate goes up and GoC 10-Year Bond Yield goes down in short term
  - i.e. BoC increased its Overnight Rate October 24, 2018 and GoC 10-year bond yield is presently -0.2bps lower than forecast

Investments

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Investments

- New investment strategy for 2018/2019 materially reduces risk
  - comingled to 5 segregated portfolios
    - Basic Claims Liability Reserve
      - minimum investment risk
    - Rate Stabilization Reserve
      - minimum to moderate investment risk depending on balance
    - Employee Future Benefits (Pension) Reserve
      - moderate investment risk

  - Risk tolerance determined by Board of Directors (experts) and influenced by portfolio type, capitalization level and historic losses
    - MPI has lost over $250m in recent years

  - Investment decisions informed by results of Mercer's ALM Study

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Investments

- Result of new investment strategy:
  - 30% reduction in RSR equity requirement
  - 100% protection against interest rate risk

- Non-selection of Real Return Bonds
  - MPI does not view inflation volatility as risk
  - ALM Study modelling does not support selection based on MPI's risk profile

Investments

- Evidence suggests a low and stable inflation environment:

Figure DCAT- 66: Canadian CPI

Line No.	Period	Mean	Standard Deviation
1	**1915-1991**	3.60%	5.40%
2	**1992-2017**	1.80%	0.70%

Viola:

- "if you look at the history and what's happened, **we're certainly in a very low -- a -- a stable inflation environment**" (T:1411)
- "And what you'll see is that inflation volatility has certainly come down, it's come down from 3 3/4 to 3 percent to .8. So we're living in unique times, **inflation is not volatile. It hasn't been historically**, but the question then is if you had to -- do you have a crystal ball to say it's going to stay like that in the future. (T:1453)

- If inflation will be high and volatile, then the DCAT doesn't reflect the risks to Basic
  - Removed 'stagflation period' from consideration
- Otherwise, MPI's assumption, and investment decisions are reasonable

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Investments

Why Buy ‘expensive’ Insurance Against a Small Risk

Viola:

- “And the insurance cost of buying real return bonds to hedge long-term inflation risk and real rate risk varies through time. All interest rates do and so **does the cost of insurance, what you give up compared to taking more risk**. (T: 1443)
- “But to the more important point, the question is: Is it worth taking the extra risk when the **cost of insuring to hedge it seems like it's fair, even though it's more costly than it used to be**? That's the relevant question.” (T: 1454)

Makarchuk:

- So if the decision was that MPI wanted to completely hedge inflation risk, the **expected returns would have been materially lower. The opportunity set for the investments would have been materially lower as well**. An investment allocation that completely hedged inflation risk as part of our preliminary modelling would have been roughly two-thirds (2/3) real return bonds. (T:324-325)

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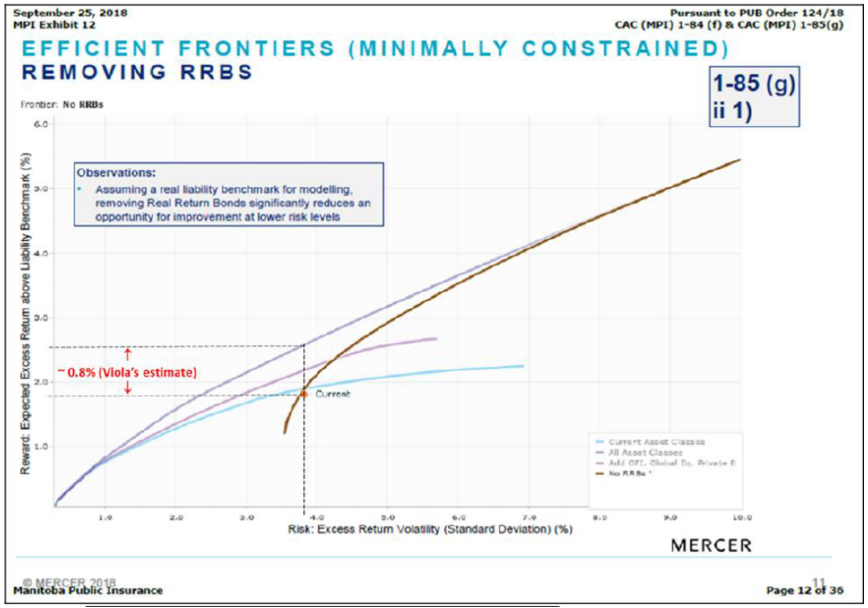
Investments

- Nominal Liability Benchmark
  - **<u>Not a Simplifying Assumption</u>**
  - Choice model static inflation, based on evidence
  - Real Liability Benchmark leads to portfolio laden with RRBs
- Viola's "cost of excluding RRBs" 0.8% opportunity cost is based on a portfolio that includes assets MPI rejected:
  - Private Debt
  - Private Equity
  - Growth Fixed Income
- **Not a fair comparison**
  - **increases other risks**



Viola:
"…Well, sorry, the 80 basis points would be lower for a more constrained portfolio that was illustrated by Mercer." (T:1575)

Investments

OUR SUMMARY PERSPECTIVE ON THE SUBSTANTIVE ISSUES RAISED BY THE CAC/PUB IN 2018

Should liabilities have been modelled with a real benchmark?

- Acknowledge a real benchmark would have better reflected inflation volatility
- MPI clearly indicated willingness to accept inflation volatility and desire to hedge nominal risk, thus a nominal benchmark was used
- The 2% inflation assumption included in the liability cashflows is reasonable from our perspective

Should the recommended asset mix hedge inflation risk?

- Hedging inflation risk was not a stated investment objective
- Most peer investors accept inflation risk … those that hedge typically hedge only a portion for various reasons
- While headline inflation has risen since the study, the consensus expectation for long-term inflation doesn't yet suggest a long-term inflation rate in excess of that modelled during the study

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Ratemaking, Expenses and Revenues

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Ratemaking, Expenses and Revenues

- Ratemaking
  - rates are made in accordance with AAP
  - no major changes in the way rates are made this year
  - **breakeven rates are separate from CMP**
  - Breakeven = revenue and costs associated with new policies
  - CMP = amount to maintain capital of basic in policy year

- MPI seeks a 0.1% increase in breakeven rates this year

- Using September 28, 2018 GoC 10-year bond yield results in a 0.26% rate decrease

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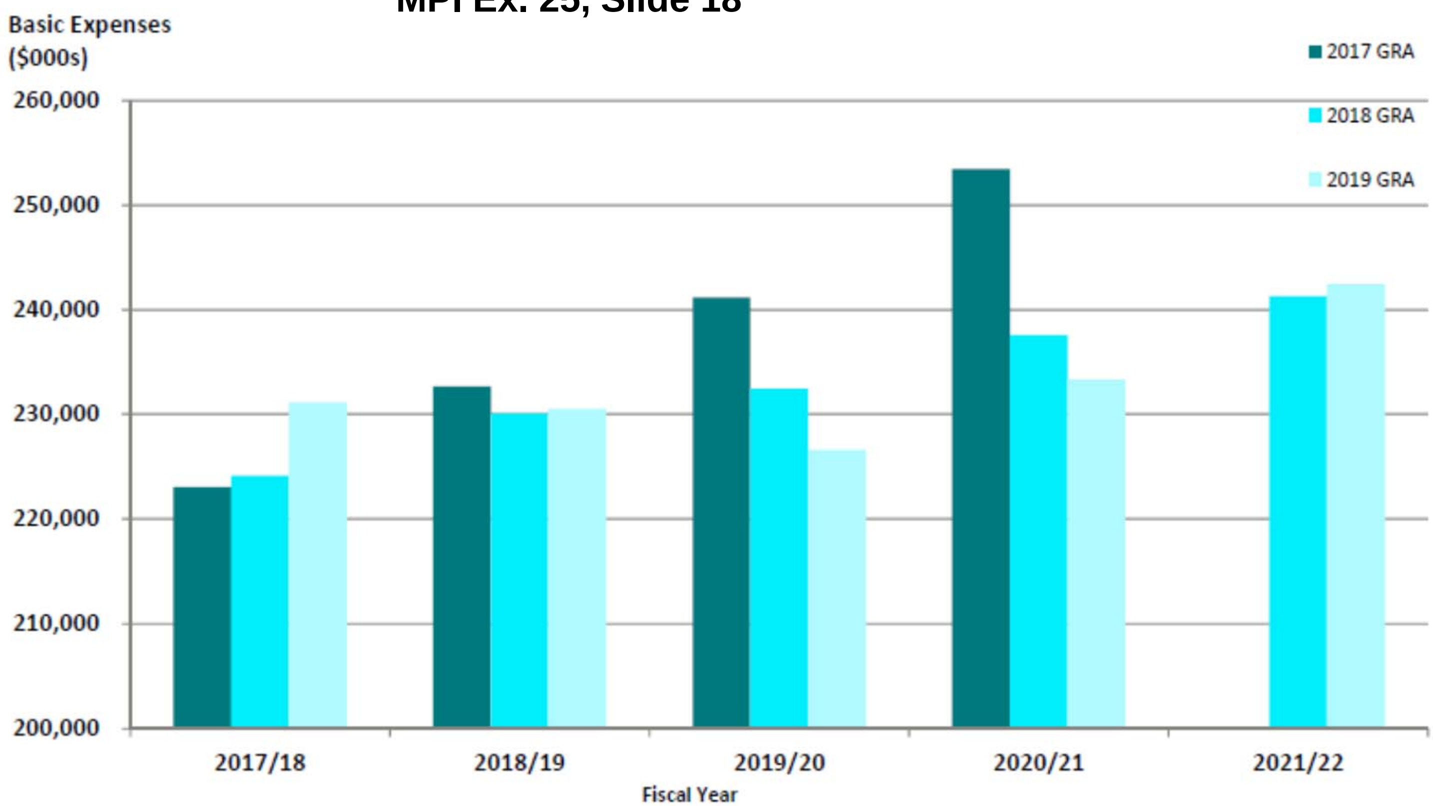
Ratemaking, Expenses and Revenues

- Expenses
  - Do not factor into Basic rate indication this year

MPI Ex. 25, Slide 18



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Ratemaking, Expenses and Revenues

- Long-Tail Bodily Injury Claims
  - Claims Intake and Triage
    - identifies complex claims earlier on
    - seeks to improve customer outcomes, close claims faster
    - resulted in an increase of 13 full-time employees
    - allows case managers to focus on tougher cases, not admin work
    - monitoring for improvement in claims costs
  - Centralized Reserving
    - case managers to centralized reserving unit
    - solves problem of optimistic reserving practices

Information Technology (IT)

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Information Technology (IT)

- PAST
  - Customer Claims Reporting System (CCRS)
  - Property Damage Re-Engineering (PDR)
- PRESENT
  - IT Strategy
  - Value Management
  - Gartner’s Assessment
  - Staffing Strategy
- FUTURE
  - Legacy Modernization

Information Technology (IT)

- PAST
  - Customer Claims Reporting System (CCRS)
    - MPI's failed attempt to be an innovator
    - Cancelled April 2018
    - MPI retains intellectual property to rely on in future
  - Property Damage Re-Engineering (PDR)
    - MPI failed to adequately cost project, focused on benefits
    - Program has standardized and improved estimating process, opened up future possibilities

Information Technology (IT)

- PRESENT
  - IT Strategy
    - ensures business needs met by IT and business capabilities
    - shift in approach to IT, aligns with Industry Best Practice
    - “where we were” vs. “where we are heading” (next slide)

Information Technology (IT)

Where we were...	Where we're headed...
Leaders in creating innovation	Adopt proven mainstream technology
Executed High risk projects	Identify all risks prior to project initiation and incorporate into project decision
Project Governance with non-business project sponsor for all projects	Project sponsor is the Operational Business Champion,
Customize out of the box software to suit our processes	Align, wherever possible, our processes to industry best practices that is incorporated in vendor provided software
Candidate projects were not vetted through a detailed value management process	Value management discipline becomes engrained in MPI process and culture
Technology driven change within the organization	IT capabilities are created to support Business Capabilities

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Information Technology (IT)

- PRESENT
  - Value Management
    - ensures new IT projects are properly informed and costed
    - applied to CCRS and PDR – results show its potential
    - required a change in culture but is now engrained
  - Staffing Strategy
    - 20 of 27 external IT consultants transitioned to employees
    - MPI continues to make progress towards goal
  - Gartner's Assessment (IT Score) – next slide

Information Technology (IT)

June 15, 2018

2019 GENERAL RATE APPLICATION
BMK Attachment A

IT Score

MPI's Executive View score is 3.4 and the Enterprise Score is 3.1. These scores will be used for year over year comparisons going forward. Opportunities exist for improvements in enterprise architecture and applications maturity.

	MPI 2016/17	Insurance Avg
Executive View	3.4	-
Applications Organization	2.4	2.4
Enterprise Architecture	2.3	3.0
Infrastructure & Operations	2.7	2.5
Vendor Management	3.0	2.5
Program and Portfolio Management	3.6	2.8
Security and Risk Management - Privacy	4.1	3.3
Security and Risk Management - Information Security	3.6	3.0
Enterprise	3.1	-

Observations:

- MPI's Executive View score is 3.4 and the Enterprise Score is 3.1. These scores will be used for year over year comparisons going forward.
- Enterprise Architecture maturity is lower than the peer group average

Recommendations:

- Focus initiatives for improvements on enterprise architecture

Note: Gartner does not provide benchmarks at the overall Enterprise level. The Enterprise and Executive score / assessments are based on a varying compilation of survey types across participants, not just a single survey.

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Gartner

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Information Technology (IT)

- FUTURE
  - Legacy Modernization
    - MPI is still determining approach
    - will apply value management process
    - MPI will be open and transparent

Vehicles for Hire (VFH)

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Vehicles for Hire (VFH)

- MPI requires final approval of 2017/2018 and 2018/2019 VHF rates for service
- MPI also applies for VFH rates for 2019/2020
- Current state:
  - its Time Band model complies with existing regulatory process and appears to be working
  - MPI continues to amass data for analysis and modification of future rates if necessary
  - DSR incentives and loss prevention strategies will help to close the gap between Taxicab VFH rates and Passenger VFH rates

Ongoing Topics

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Ongoing Topics

- Driver Safety Rating (DSR)
  - PUB 130/17 approved a 1.8% increase in driver premiums through the demerit side of the DSR Scale
  - Technical conference ordered and held on March 20, 2018
  - DSR based driver premiums should be actuarially sound
  - MPI is considering options for alternative models and will consult with the public
  - MPI plans to provide update or results of analysis in 2020 GRA

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Ongoing Topics

- Service Fees
  - MPI is not seeking changes for any services fees in this GRA
  - MPI is not seeking to introduce any new service fees in this GRA
  - Conducted service fee review in 2017/2018
  - Results included with 2019 GRA
  - MPI is waiting for decision on changes by Manitoba to Driver Vehicle Act (DVA) service fees
  - Will provide update in 2020 GRA

Conclusions

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Conclusions

1. MPI's Basic rate indication is **just** and **reasonable**
   - PUB must decide whether to use rates as at
     a. February 28, 2018
     b. September 28, 2018 or
     c. date selected for compliance filing

2. 2018/2019 VFH rates should be approved based on current methodology

3. Final approval should be given to 2017/2018 and 2018/2019 VHF rates

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All of which is respectfully submitted.

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Legal Counsel for MPI**

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