

Are we Losing Balance? Captive Ratepayers and the MPI General Rate Application

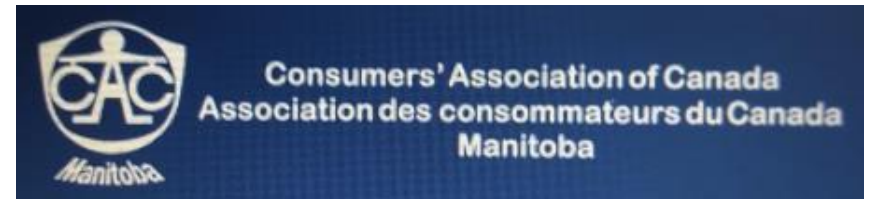
Opening Statement of the Public Interest Law Centre on behalf of
the Consumers' Association of Canada (Manitoba Branch)

October 7, 2019

2020/21 Manitoba Public Insurance (MPI) General Rate Application (GRA)

CAC Manitoba

- Close to three decades of rate hearings under Crown corporation governance legislation
- Core Consumer Rights
 - To be informed
 - To choice (or be involved in the regulatory process as a proxy for choice)
 - To have a voice in marketplace decision-making
 - To consumer education



Developing the CAC Manitoba Position

- Ongoing and regular consumer contact
- Consumer engagement, including both CAC Manitoba engagement and review of MPI surveys filed in this application
- CAC Manitoba Board
- Advice from expert advisors

Experts who are highly qualified and independent

- It is your duty to provide evidence that:
 - Is fair, objective and non-partisan;
 - Is related only to matters that are within your area of expertise; and
- Your duty in providing assistance and giving evidence is to help the Public Utilities Board. This duty overrides any obligation to the Manitoba Branch of the Consumers' Association of Canada.

The test

- Just and reasonable rates
 - [*Public Utilities Board Act*, s 77] [*Crown Corporations Governance and Accountability Act*, s 25]
- 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)]
- In setting just and reasonable rates, “(t)he PUB has two concerns when dealing with a rate application; the interests of the utility’s ratepayers, and the financial health of the utility. Together, and in the broadest interpretation, these interests represent the general public interest.”
 - *Consumers’ Association of Canada (Man.) Inc et al v Manitoba Hydro, Electric Board*, 2005 MBCA 55, at para 65.

Setting Just and Reasonable Rates

- ensuring that MPI's forecasts are reasonably reliable;
- ensuring that actual and projected costs incurred are necessary and prudent;
- assessing the reasonable revenue needs of the Corporation in the context of the overall general health of MPI;
- determining an appropriate allocation of costs between classes; and
- setting just and reasonable rates in accordance with statutory objectives.
 - [PUB Order 98/14, p.28]

In this hearing, the overarching themes that CAC Manitoba intends to explore is:

- Whether, through no fault of the PUB, the long standing balance under the independent rate approval process between the interests of captive ratepayers and the health of MPI is in danger of being tipped in favour of the interests of MPI and of certain industry players, at the expense of consumers?
- Are the interests of ratepayers being subordinated to the risk appetite of MPI and to the pecuniary interests of certain industry players?

Dynamic Regulatory Process

- CAC Manitoba expert evidence re-examines the interplay of costs and benefits between Basic and Extension, while remaining grounded in regulatory principles, and the PUB's responsibility.
- The rate approval process should be responsive to evolution in the marketplace and learning from the experience in other jurisdictions, while remaining grounded in regulatory principles relating to ratemaking and the statutory framework.

Ensuring that forecasts are reasonably reliable for rate approval purposes

- What are the implications for the reliability of the claims cost forecast of the Corporation's ongoing challenges with respect to the management of weekly indemnity claims?
- Recognizing the determinations of the PUB with regard to the naive forecast methodology, what are the implications for the 2020 rate application of current interest rates?
- Leaving aside methodological issues but recognizing the interplay between Basic and Extension, what is the magnitude and probability of interest rate risk on the reliability of revenue and expense forecasts and on the reliability of projected transfers from Extension?

Necessary and Justified [prudent] management

Operating Costs

- How does operating cost growth in the current application compare to the operating cost growth allowed for rate approval purposes by the PUB in its most recent Manitoba Hydro General Rate Application Order (see PUB Order 69/19 at p 24)?

Broker Compensation and Evolving Markets

- How does the role of brokers in a market dominated by MPI differ from the role of brokers in a competitive market? Should that difference be reflected in broker compensation?
- Given significant and ongoing changes in the role of brokers in the broader market, what are the implications, if any, for customer service and broker compensation?

Broker Compensation and the Manitoba Market

- Recognizing that the rate approval authority of the PUB is limited to Basic rates but that generally accepted regulatory principles and the current statutory framework enable the examination of intimately related affiliates, what are the implications for broker compensation of the unique dynamics of the Manitoba marketplace including:
 - multi-year term products such as vehicle insurance;
 - the intertwined relationship of Basic and Extension in MPI operations as well as in the actual purchase by consumers of vehicle insurance;
 - the intertwined relationship of Basic and Extension in broker compensation negotiations between MPI and the industry; and
 - proposed transfers from Extension reserves to Basic reserves through the Capital Management Plan?

What role do brokers play in reassessment years

- Is it accurate to assume that brokers often do not play a significant role in reassessment years (up to four years) for multi-year term products, such as vehicle insurance?
- Is it prudent and reasonable to pay trailing fees for reassessment years in which the broker may not play a significant role? Or would it be prudent and reasonable to consider alternative fee approaches?

Brokers and Guaranteed Compensation Levels

- In light of changing market dynamics including:
 - multi-year term products such as vehicle insurance;
 - the materially changing role of brokers in the North American market; and
 - potentially increased demand and growing expectations of consumers for on-line purchase and renewal services;
- is it prudent and reasonable for MPI to include a “minimum compensation guarantee” of \$71 million annually in its agreement with brokers (see CAC (MPI) 1-1, Appendix 15)?

Brokers, Consumer Choice and Accessibility and Evolving Markets

- Is the existing bricks and mortar model of insurance purchase and renewal accessible to all Manitobans or are there important underserved markets?
- To the extent there are important underserved markets, do market dynamics in these regions suggest that bricks and mortar models are unlikely to be effective in making purchase and renewal more accessible?
- Does the option of online insurance, self-serve and mobile service purchases have the potential to cost-effectively enhance the accessibility and quality of customer service in a time of evolving needs and expectations?

Brokers, Consumer Choice and Accessibility and Evolving Markets (cont.)

- What are the trade-offs in terms of cost, customer choice and accessibility in terms of the different online insurance purchase and renewal service delivery models?
- Should consumers wishing to buy or renew their insurance online have the option of choosing whether to conduct that transaction directly with MPI or through a broker or are models which require consumers to designate a broker desirable?

Brokers and Evolving Service Delivery Models

- What will the future operational model look like, in light of the evolving needs and expectations of customers and the Legacy Systems Modernization (LSM) project? What are the implications for MPI, brokers and customers?
- What is the appropriate role and compensation model for brokers in light of potential significant changes to MPI's operational model and technological disruption in the marketplace?

Brokers and Evolving Service Delivery Models (cont.)

- Are there opportunities for MPI to improve consumer options for the purchase and renewal of insurance while maintaining or lowering costs? What are the potential trade-offs in doing so?
- Has MPI conducted or is it planning to conduct sufficient consumer engagement regarding its operational model, including the provision of online services?

MPI Agreements and Service Providers

- What are the implications, if any, under competition law of service provider organizations, such as brokers, chiropractors, repair shops, entering into agreements with MPI at negotiated rates? (see for example CAC (MPI) 1-1 p))
 - Sections 78-79 of the Competition Act prohibit abuse of dominant position by a firm or multiple firms. The three elements to establish abuse of dominant position are:
 - (a) one or more persons substantially or completely control, throughout Canada or any area thereof, a class or species of business;
 - (b) that person or those persons have engaged in or are engaging in a practice of anti-competitive acts, and
 - (c) the practice has had, is having or is likely to have the effect of preventing or lessening competition substantially in a market.

MPI Agreements with Service Providers (cont.)

- In the event there are competition law issues, what are the implications, if any, for the Basic rate approval process and for MPI's costs and the risks it faces?
 - For example, have costs paid to service providers been inflated because of negotiations with service provider organizations?
 - Are there other models that can be used to determine appropriate commissions and fees that would address any competition law issues?

Information Technology – Legacy Systems Modernization Project

- Given that the Legacy Systems Modernization (LSM) project is the largest Information Technology project in MPI's history at \$106.8M, is MPI taking the necessary steps to ensure that the project is successful, especially in the aftermath of Physical Damage Re-Engineering?
- Have the recommendations from LSM assessments by Deloitte and Avasant been appropriately responded to and incorporated in MPI's LSM project plan? (details confidential)
- Is MPI positioning itself adequately in light of significant changes to job roles, technologies, business processes and ultimately to its business culture as the organization move towards embracing the 'digital enablement' of its core business?

Information Technology – Legacy Systems Modernization Project (cont.)

- Is the MPI business case for LSM credible under its existing assumptions?
- If so, would the MPI business case for LSM continue to be viable if consumers were obliged to employ a broker in conducting on line purchases rather than having the option of choosing to transact directly with MPI?

Benchmarking

- What are the implications of MPI discontinuing the services of Ward Group and Gartner with respect to benchmarking?
- How will MPI ensure that its costs remain reasonable, especially in light of its Information Technology Full Time Equivalents, its overall Infrastructure and Operations Spending and its maintenance costs being higher than peer organizations?

Investment Portfolio – Shadow Portfolios

- Will the Shadow Portfolios, which were ordered by the PUB in Order 159/18 achieve the objectives identified by the PUB?
 - PUB Order 159/18: *“That said, the Board recognizes that it may be the case that the Corporation **has foregone an opportunity** to hedge against long-term risks by rejecting Real Return Bonds and reducing real assets in its new portfolio. To that end, the Board has directed that the Corporation run shadow portfolios to be evaluated against the portfolios selected by the Corporation. The Board expects that the shadow portfolios and the post- implementation review will serve to inform it, and the Corporation, as to whether the Corporation's ALM strategy is reasonable. If a review in the 2020 GRA indicates that the Corporation did not employ a reasonable strategy, the Board will comment further at that time.”* (p 9-10) (emphasis added)

Investment Portfolio – Shadow Portfolios (cont.)

- Were the Shadow Portfolios developed in a way that will allow the measurement of foregone opportunities, as directed by the PUB?
- Are the criteria (e.g. investability) and assumptions (e.g. market risk and credit risk levels) used by Mercer/MPI in developing the Shadow Portfolios appropriate, given the PUB's objective in Order 159/18?
- Is the methodology used by Mercer/MPI to create Shadow Portfolio 1 (“constrained”) and Shadow Portfolio 2 (“unconstrained”) appropriate?
- What are the differences in returns between the Shadow Portfolios and other portfolios (e.g. actual portfolio, policy/benchmark portfolio), as well as differences in risk?

Risk Management Framework as it relates to investments

- Is MPI's tolerance or appetite for different types of risk (e.g. inflation risk, equity risk) reasonable in relation to the expected returns from taking different types of risk or does it unduly penalize consumers?

Management of Weekly Indemnity claims

- Does the evidence demonstrate ongoing challenges with respect to the forecasting and management of Weekly Indemnity claims, in light of the Comparison of Actual with Expected Experience in Previous Year-End Valuation for Accident Benefits – Weekly Indemnity showing adverse development of prior accident years for every valuation since February 2013?
- What are the implications of any challenges with respect to Weekly Indemnity claims for the 2020/21 revenue requirement and for management of Weekly Indemnity claims going forward?

Road Safety

- Without a provincial budget outlining what various parties are contributing to the issue of road safety in Manitoba (including activities and budgets), how can the PUB ensure that MPI's road safety portfolio is optimized?
- Has MPI demonstrated that it is working with other stakeholders, including the City of Winnipeg and other municipalities?
- How will MPI's 2021 updated Road Safety Operational Plan and Framework and its methodology for setting the road safety budget relate to and take into account activities by other stakeholders in Manitoba with the goal of optimizing costs spent on road safety?

Road Safety (cont.)

- What conclusions can be drawn with respect to MPI's road safety portfolio from the lack of a First Nation strategy, including the fact that MPI collects no data on First Nations?
- Has MPI provided sufficient evidence to support the High School Driver Education Program (Driver Z) business case?
- Has MPI demonstrated that it is adequately addressing issues relating to road safety for vulnerable road users, including pedestrians?
- Has MPI undertaken recommended actions relating to medically-at-risk pedestrians, including pedestrians who use mobility aid devices?

MPI Service Centres

- MPI is considering repurposing certain Service Centres to minimize building expenses as the business is 'digital enabled'. How should these costs be treated for rate approval purposes?

Overall Health of the Corporation – Including Risk and Appropriate Reserves

Reserves Regulation

- Does the independent rate approval authority of the PUB include the authority to set the Rate Stabilization Reserve (RSR) level for rate setting purposes, to consider the appropriate methodology for determining the RSR level and to approve premiums related to the build up or reduction of the RSR to within approved levels?
- If so, is the *Reserves Regulation* invalid given its conflict with the independent rate approval role of the PUB?

Reserves Regulation (cont.)

- If the *Reserves Regulation* is valid, is it binding on the PUB in the exercise of its independent rate approval process for Basic insurance, as reflected in the interaction of the *PUB Act*, the *Crown Corporations Governance and Accountability Act* and the *MPI Act*?

Reserves Regulation (cont.)

- If the *Reserves Regulation* is valid and binding on the PUB, what are the implications for rate approval of the mandatory language in the *Reserves Regulation*, which dictates that the “minimum amount” the corporation “must maintain” in its Basic insurance RSR is the amount determined using a MCT ratio of 100%?
 - Can MPI's proposed 5-year plan to reach the 100% MCT target in the Capital Management Plan be reconciled with the mandatory direction of the *Reserves Regulation*? If not, what are the implications for the Corporation and for ratepayers?

The Capital Management Plan

- In assessing any Capital Management Plan (CMP) and recognizing the intimate relationship between Basic and Extension, is the proposed transfer from Extension to Basic consistent with the benefit Extension enjoys because of its relationship with Basic?
- Given the reliance of Extension on Basic, what principles should inform the rate approval process and transfers from Extension? Is a mechanistic CMP appropriate or should regulatory principles inform the magnitude of any transfers from Extension to Basic?
- Recognizing that the *Reserves Regulation* subordinates consumer interests and PUB risk tolerances in the setting of just and reasonable rates to the risk appetite of MPI, what are the implications for the pace at which reserves should be rebuilt, as proposed in the CMP?

The Capital Management Plan and RSR Target v Range

- Given the purpose of rate stability inherent in the RSR, does a target range, with a minimum and maximum threshold, achieve greater stability than a specific target amount or MCT ratio?

Net Capital Maintenance Provision and Rates in Accordance with Accepted Actuarial Practice

- Is it reasonable for MPI, in its rate application, to have tested the adequacy of the current approved rate levels, including the portion related to the Net Capital Maintenance Provision approved for one year in Board Order 159/18?

Expected Return on Investment Assets and Rates Set in Accordance with Accepted Actuarial Practice

- Is it reasonable for the Corporation not to be recognizing expected return on investment assets supporting Basic Total Equity in rates set in accordance with accepted actuarial practice?

Accepted Actuarial Practice rates and the calculation of rebates and surcharges

- Should rebates and surcharges be calculated separately from the actuarial rate calculation?

Affordability versus Stability

- What does the survey evidence in the proceeding tell us about the priority consumers place upon the affordability of rates offered by the MPI monopoly and related insurance services?
- Are consumer concerns with affordability synonymous with the alleged MPI focus on rate stability or can the concepts be distinguished?
- If so, what are the implications for any Capital Management Plan?
- Should a formal definition of rate shock be developed for the purposes of the Capital Management Plan and other rate approval considerations and if so, should it reflect engagement with MPI customers?

Appropriate Level for the Rate Stabilization Reserve

- Assuming the *Reserves Regulation* is not valid, what is the appropriate methodology to set the RSR target level for rate approval purposes, in light of:
 - the work accomplished through the regulatory process in past years leading to a methodology based on the Dynamic Capital Adequacy Test to set the RSR target range;
 - previous findings by the PUB that the 100% MCT is not appropriate as an upper threshold for MPI's RSR (see PUB Order 162/16, p 60); and
 - recent developments in British Columbia where the 100% MCT target has been suspended?

An appropriate allocation of costs between classes and lines of business (and between drivers and vehicle owners)

13-month Rating Year

- What is the impact of the proposed 13-month rating year on customers renewing in March 2021 and all other customers, in particular as it relates to fairness between customers and intergenerational equity?

Risk of Damage

- Is a factor in determining appropriate insurance premiums the risk and magnitude of damage inflicted by a vehicle on others? If not, should it be?

Driver Safety Rating

- CAC Manitoba was pleased to see an engagement strategy in the spring of 2019, which examined multiple options, as well as their strengths and advantages, and engaged the public and stakeholders.
- What are the necessary steps to be taken by MPI as it relates to pricing of options, a review of other jurisdictions, future consumer engagement and decision-making?
- How should MPI balance views of consumers with fairness between consumers, especially as it relates to premiums being based on risk, and cost-efficiency to the Corporation?

Setting just and reasonable rates in accordance
with statutory objectives

Thank you