Note on the use of the Minimum Capital Test (MCT) for use by Manitoba Public Insurance to set Rate Stabilitization Reserve (RSR) Levels

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Background

It is on record that, in my opinion, it is unsuitable for a crown monopoly, such as Manitoba Public Insurance (MPI) to use the Minimum Capital Test (MCT) as the determinant of a rate stabilization reserve (RSR) level. The reasoning behind that is that the MCT is a "harmonized capital adequacy solvency test" [1] that is calibrated for private insurance companies who are federally regulated. Federally regulated companies tend to write insurance in various provinces and write several products, such as homeowner, condominiums, automobile (personal and commercial), as well as commercial property products. Private insurance companies have different goals and structures from each other and from MPI.

If one were to successfully argue that the MCT should be used by MPI the question would be at what level of MCT should MPI operate. The RSR level at which MPI is suggesting they operate (100% MCT) does not have any substantiation in modelling such as would come from Dynamic Capital Adequacy Testing (DCAT). Questions related to that show that it is nearly impossible for MPI to go insolvent (.02% probability) if they were to hold capital at the 100% MCT level.

The risks MPI faces are very different from a federally regulated private insurance company. MPI cannot price itself out of the market so is not subject to competitive risk. They cannot grow uncontrollably, which is a highly cited reason for Property & Casualty insurer insolvency. Manitoba has a limited amount of growth in terms of customers and vehicles. MPI's unpaid claims are from one automobile product which is very stable rather than several different automobile products in different provinces, mixed in with various personal and commercial products. This leads one to question if the factors determined for the MCT, based on private companies, are applicable to a crown monopoly, such as MPI, writing one product in one province.

MPI comes to the PUB every year with a full application outlining its actions and its plans. The rate need over one year will not grow so much from one year to the next with prudent management and accurate forecasting that a large capital reserve is necessary to prevent rate shock to Manitoba vehicle owners. In a private market not all products have rates that are regulated.

Lastly, the PUB has to decide how much of the Manitoban policyholder moneys should be held by MPI. At what point does it hurt the average Manitoba citizen

1 Minimum Capital Test Guideline for Property and Casualty Insurance Companies

more than it supports them to pay automobile premiums higher than absolutely necessary so that MPI can hold capital to prevent the unthinkable?

Undertaking

From the hearing transcript of October 21, 2019 an undertaking was entered as "CAC to provide an analysis on a theoretical basis or a conceptual basis of Appendix 1(d) of the DCAT section of the application to indicate whether there are any specific elements within the derivation of the MCT ratio that are of questionable applicability to a public Crown Corporation".

On a theoretical basis the arguments laid out in the background section above apply. MPI faces many of the risks that a private insurance company does, including those laid out in Appendix 1d to the DCAT, but at a very different level. The level of uncertainty in Premium Liabilities for MPI would be very different from that of a private insurance company writing in several different provinces with many different products that is experiencing unprecedented growth in one of those provinces. The uncertainty related to the private company in that circumstance is very different and much larger than any uncertainty MPI experiences with its premium liabilities.

The Unpaid claims uncertainty when a private insurer is entering a new province is very different than MPI's uncertainty around its book of Manitoba policyholders purchasing their auto product.

The level of interest rate risk experienced by MPI should be much lower than that experienced by companies who write business in many different countries.

In order for the MCT to be applicable to MPI the tests within would have to be examined and recalibrated to a public monopoly writing business in one province with one product. In order to do that models would have to be ran to see if the level of risk is the same as those contemplated in the MCT. For example, the MCT has a 10% risk factor for unpaid claims related to Auto – Liability. Would this risk factor apply to MPI, given its product and limited regional distribution? Models would have to be ran in order to determine that, models that can be ran through the DCAT exercise.

A substantial amount of research would be needed to examine and explain the derivation of the MCT risk factors that time does not permit.