

Order No. 124/18

**MOTION BY CONSUMERS' ASSOCIATION OF CANADA (MANITOBA) INC.
FOR AN ORDER COMPELLING CERTAIN RESPONSES TO INFORMATION
REQUESTS IN THE 2019/2020 GENERAL RATE APPLICATION**

September 14, 2018

BEFORE: Robert Gabor, Q.C., Chair
Irene A. Hamilton, Member
Robert Vandewater, Member
Carol Hainsworth, Member

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1. SUMMARY

By this Order, The Public Utilities Board (Board) grants the Motion of Consumers' Association of Canada (Manitoba) Inc. (CAC) to compel Manitoba Public Insurance (MPI or the Corporation) to provide responses to certain Information Requests (IRs) made by CAC in the 2019/2020 General Rate Application (Application or GRA).

1.0 Overview

MPI filed the Application on June 15, 2018. On June 29, 2018, the Board issued Procedural Order 82/18 granting CAC intervener status in the 2019 GRA and establishing a timetable which included two rounds of IRs.

Order 82/18 also established a Final Issues List for the 2019 GRA which included, as an issue requiring more detailed consideration:

21. Asset Liability Management Study, including review of all aspects of the [Mercer ALM] Study recommendations and implementation thereof, the basis for evaluation of risk and return, alternative portfolio compositions, proposed portfolio segregation and recommended composition of the investment portfolio(s), forecast investment performance and changes to the Investment Policy Statement.

The Mercer Asset Liability Management Study referred to in Order 82/18 was the result of a directive issued in Board Order 162/16, following the 2017 GRA.

1.1 *Asset Liability Management*

The Board has reviewed the issue of MPI's asset liability management in recent General Rate Applications. In Order 151/13, issued following the 2014 GRA, the Board directed MPI to have the composition of its investment portfolio reviewed by an external expert consultant, with a view to determining whether the current asset mix should continue, or should be revised. MPI engaged Aon to complete the ALM Study in 2014 (Aon ALM Study), and filed the study in the 2016 GRA.

A significant portion of the 2017 GRA was dedicated to reviewing MPI's Investment Portfolio and the Aon ALM Study. In the 2017 GRA, a witness from Aon provided testimony on the Aon ALM Study. CAC called Mr. Valter Viola as an expert in (1) investment portfolio management; (2) investment portfolio research, economics and risk management; and (3) quantitative asset liability modeling.

In Order 162/16, issued following the 2017 GRA, the Board ordered MPI to obtain an updated asset liability management study, to be filed with the 2018 GRA. That study was to address each of the recommendations made by Mr. Viola in the 2017 GRA hearings.

On June 15, 2017, MPI filed the 2018 GRA but did not file an updated asset liability management study as directed, stating that it was not "logistically possible" to do so within the time frame provided and that, secondly, an updated study could not be usefully and purposefully completed in the absence of Board approved Basic Rate Stabilization Reserve Targets.

Notwithstanding this, during the 2018 GRA hearings, the Corporation advised the Board that it had issued a Request for Proposals for the updated asset liability management study on September 12, 2017 and had engaged Mercer Canada (Mercer) to deliver the study by November 30, 2017, having put in place an accelerated process to have the study produced.

In Board Order 130/17, issued after the 2018 GRA, the Board expressed its dismay that MPI had failed to comply with the Board's directive in Order 162/16 concerning an updated asset management liability study, and that the timing of Mercer Canada's engagement rendered any study of limited utility in the 2018 GRA. The Board directed the Corporation to file the study to be prepared by Mercer Canada (Mercer ALM Study) with the Board concurrently with its delivery to the MPI Board of Directors, and to provide an update of the Mercer ALM study as necessary to: (a) take into account the directives issued in Order 130/17; and (b) address each of the 18 recommendations made by Mr. Viola as set out in Order 162/16.

In Order 130/17 the Board also ordered that a Technical Conference be held to review the Mercer ALM Study, with the information shared at the Technical Conference to be included in the 2019 GRA. The Technical Conference took place on March 2, 2018 with MPI, CAC and Board Advisors participating.

The Mercer ALM Study was prepared in three phases, the last being filed with the Board on February 2, 2018. Additional information concerning the Mercer ALM Study was filed with the Board as part of the current GRA.

The Mercer ALM Study identifies unique investment portfolios for each class of MPI's liability, including Basic Claims, Basic's Rate Stabilization Reserve and Future Employee Benefits (primarily pension), and develops efficient frontiers for each portfolio based on modelling utilizing multiple combinations of asset classes.

MPI filed an ALM Implementation Plan in the GRA, in which it reported on the Technical Conference. MPI reported that Board Advisors and CAC had expressed concern about the level of detail and analysis provided in the Mercer ALM Study. The Board expected to see the details of the assumptions supporting the analysis conducted by Mercer, the frontiers and options considered along the frontiers, and additional justification for duration matching approach in the 2019 GRA. During the Technical Conference, CAC focused on the assumptions adopted by Mercer, particularly the interest rate forecast, inflation correlations, risks associated with heavy emphasis on fixed income and the foregone returns to ratepayers resulting from the selected reduction of risks.

1.2 *Information Requests CAC (MPI) 1-84(f) and 1-85(g)*

On July 11, 2018, CAC filed and served its First Round IRs. On August 8, 2018, MPI filed and served responses to the First Round IRs in which it refused to respond to CAC (MPI) 1-84(f) and 1-85(g) (attached as Appendix A to this Order). In summary, the IRs in question sought further analysis from Mercer. MPI's reasons for the refusal were that:

- a) The requested analyses were predicated on inflation forecast assumptions that Mercer and the Corporation rejected in the early stages of the Mercer ALM Study as not probable;
- b) CAC had not provided any evidence that the inflation forecast used in the Mercer ALM Study was sufficiently inaccurate, or flawed in some way, so as to call into doubt the results;
- c) The requested analyses would not add any meaningful evidence to the record; and
- d) The costs of re-running the modeling as requested would be in excess of \$30,000.00 and it would not be prudent to incur those costs. MPI later revised this estimate, to be in excess of \$46,000.

CAC filed the within Motion on August 8, 2018, seeking an Order compelling MPI to answer CAC (MPI) 1-84(f) and 1-85(g).

On August 15, 2018, CAC filed further submissions in support of its Motion consisting primarily of previously filed evidence and information from Mr. Viola in the 2017 GRA,

asserting the importance of accurately determining estimated risk based upon modelling using real, rather than nominal, interest rate and inflation risk.

On August 20, 2018, MPI filed its Motion Brief, together with the affidavit of Glenn Bunston, Manager of Investments for MPI, in response to the CAC Motion. On August 28, 2018, CAC filed a Reply to MPI's Motion Brief.

On September 7, 2018, MPI filed a supplemental affidavit of Glenn Bunston, to correct errors in the Bunston affidavit filed August 20, 2018.

The Board did not require an oral hearing on the Motion.

2.0 PARTIES' POSITIONS AND BOARD FINDINGS

2.1 CAC

CAC took the position that MPI should be compelled to respond to the IRs in question on the basis that they are relevant to the Board's assessment of the Mercer ALM Study, as the information goes to the overall credibility of the Mercer ALM Study and whether it was biased by choices made by MPI.

CAC pointed out that there has been an ongoing debate over successive GRAs as to whether MPI is assuming an undue level of risk, resulting in an inadequate return, due to its failure to appropriately hedge against real interest and inflation risks in its portfolio. According to CAC, the IRs in question relate to the same or similar issues reviewed in the

2017 GRA in respect of the Aon ALM Study; namely, the sensitivity of optimization models to their base assumptions, including assumptions relating to interest rates.

CAC indicated that CAC (MPI) 1-84(f) relates to Mr. Viola's Recommendation 13, and CAC (MPI) 1-85(g) relates to Mr. Viola's Recommendation 7. It was CAC's position that the responses to these recommendations, as set out in the Mercer ALM Study, are not complete, as directed by Order 130/17.

CAC stated that the IRs in question asked Mercer to re-run the efficient frontier model under different assumptions, arguing that the modelling of efficient frontiers for the purposes of investment decisions can be highly susceptible to key assumptions, including assumptions relating to interest rates. The purpose of the IRs is to test MPI's decisions regarding key assumptions on which the Mercer ALM Study is based, to understand the implications of those assumptions, and to determine whether the assumptions and constraints imposed in the Mercer ALM Study were appropriate. According to CAC, the Mercer ALM study is potentially vulnerable given the simplifying assumption about the nature of the liabilities (Nominal vs. Real), and it is important to understand the implications of that assumption. If different liability assumptions were used, it is possible that alternative portfolio compositions would have been recommended. This is central to the issue being examined by the Board in the GRA.

CAC stated that while its consultants might be able to prepare a comparable analysis, MPI would likely challenge the calculations requiring Mercer to undertake a similar

analysis itself in order to compare results. In addition, CAC stated that its consultants could not replicate multi-period scenarios. CAC therefore argued that it would be more cost efficient to have Mercer re-run its modelling based on the assumptions provided.

2.2 MPI

MPI made five points as to why the Board should not issue the Order requested:

- a) The IRs are not proper questions;
- b) MPI's decision-making and investment strategy are reasonable;
- c) The IRs cannot be answered as the information does not exist and cannot be obtained with reasonable efforts;
- d) The effort and cost of obtaining the information required to answer the IRs exceeds the anticipated value of that information; and
- e) CAC can obtain the information sought without the assistance of MPI.

MPI objected to the imperative nature of the IRs, arguing that they were not proper questions, because they demand new evidence and do not seek to provide a party with a satisfactory understanding of the matters to be considered. While recognizing that rate application proceedings are somewhat different than court proceedings, MPI nevertheless urged the Board to equate IRs to interrogatories in the context of litigation.

MPI submitted that, in the litigation context, it is not proper to demand that a third party create or produce new evidence through an interrogatory.

MPI further argued that the costs and anticipated benefits of creating information in order to respond to an IR ought to be considered, and that one of the costs associated with compelling the production of new evidence is that it would imply that the decisions made by the MPI Board of Directors and its Investment Committee, which has significant expertise in investments, were not reasonable. MPI argued that the Board should measure MPI's decision-making on the basis of a standard of review of reasonableness as used by courts in the administrative law context. MPI argued that it was reasonable for MPI to rely upon the recommendations of Mercer, including Mercer's recommendations as to the modelling used in the Mercer ALM Study. In addition, MPI argued that CAC provided no evidence to either refute the inflation assumptions underpinning the investment strategy adopted, or demonstrate that it was unreasonable for MPI to rely upon Mercer's recommendations.

MPI further pointed out that Rule 16(b) of the Board's Rules of Practice and Procedure provides that a party may refuse to provide a full and adequate response "where the information necessary to provide an answer is not available or cannot be provided with a reasonable effort." At a cost of over \$46,000, MPI submitted that it could not provide the information with reasonable effort. MPI further argued that the cost of obtaining the information requested would exceed its expected benefits.

MPI argued that Mercer's inflation forecast is consistent with the mid-point of the Bank of Canada's inflation target band, and that CAC had not established some credible deficiency in the forecast or provided any evidence to refute the inflation assumptions underpinning the investment strategy it adopted.

MPI further stated that the analysis requested by CAC would extend the current analysis in a direction, the results of which are already known, and that such an analysis was abandoned at the early stage of the Mercer ALM Study.

Finally, MPI submitted that CAC could obtain the information sought without the assistance of MPI and that CAC conceded that it has access to the tools and expertise required to perform the analysis.

2.3 CAC Reply

In its reply, CAC argued that the record currently before the Board raises the concern that MPI's understanding of the liability risk it faces is unsatisfactory, and that both the decision-making standard and process used by MPI for selecting its asset allocations is unreasonable.

Accordingly, CAC argued that the responses to the IRs in question would clarify the current record, and therefore, the understanding of the effectiveness of MPI's interest rate risk management practices and decision making standard and processes.

2.4 *Board Findings*

Rule 14(1) of the Board's Rules of Practice and Procedure provides that IRs are to be directed to a party for the purpose of a satisfactory understanding of the matters to be considered. IRs must be relevant to the proceeding.

Rule 15(1) provides, among other things, that where an IR has been directed to a party and served on that party in accordance with the Board's directions, the party shall provide a full and adequate response to the IR.

Pursuant to Rule 16, a party who is unable or unwilling to provide a full and adequate response to an IR (referred to as an "interrogatory" in the Rule) shall file and serve a response:

- a) Where the party contends that the interrogatory is not relevant, setting out specific reasons in support of that contention;
- b) Where the party contends that the information necessary to provide an answer is not available or cannot be provided with reasonable effort, setting out the reasons for the unavailability of such information, as well as any alternative available information in support of the response that the party considers would be of assistance to the party making the information requests;

- c) Where the party contends that the information sought is of a confidential nature, setting out the reasons why it is considered confidential and any harm that would be caused by making it public; or
- d) Otherwise explaining why such a response cannot be given.

The object of every General Rate Application is to obtain Board approval for rates that are just and reasonable. The onus is on MPI throughout as applicant to demonstrate that the rates requested are just and reasonable. Just and reasonable rates are those which strike the appropriate balance between the interests of ratepayers to pay no more than necessary for the services they receive and ensuring that the applicant, in the case of a public service provider, is financially able to fulfill its statutory mandate.

Essential to a determination as to whether rates requested are just and reasonable is a review of the Corporation's management practices. In particular, this includes a review of management decisions which affect rates, such as operating expenses and investments. Such practices and decisions are reviewed on the basis of a prudence evaluation, which requires the Corporation to demonstrate that it has taken into account the best interests of its ratepayers.

In order for there to be meaningful consultation with and input from Interveners, the Board must maintain a robust pre-hearing inquiry process for the benefit of all concerned. The IR process not only assists the Board and interveners to understand all aspects of the

GRA, but also develops a complete and unbiased record upon which the determination of just and reasonable can be made.

In the circumstances of the present Motion, concern with the performance of MPI's investment portfolio has been the subject of review over successive GRAs, resulting in of the Aon and Mercer ALM studies. From the outset of the present Application, the Mercer ALM Study was identified in the Final Issues List as an issue requiring more detailed consideration.

CAC's challenge to MPI's investment policy has also been consistent through successive GRAs. A central theme of Mr. Viola's review of MPI's investment policy in the 2017 GRA was that it demonstrated poor liability protection against real rate risk and unexpected inflation. Ultimately, the Board decided in Order 162/16, and confirmed in Order 130/17, that a further asset liability study was needed to specifically address each of Mr. Viola's 18 recommendations.

The Board has carefully considered MPI's rationale for refusing to fully respond to the IRs in question but respectfully disagrees that the refusal is justified in the circumstances of the present case.

With respect to the propriety of the IRs, the imperative nature of the IRs in question does not make them invalid. The Board would point out that IRs in applications frequently require MPI to undertake further modelling and the running of scenarios based on alternatives not previously adopted or applied by MPI in preparing the application. While

IRs do bear similarities to interrogatories as utilized in the court process, the Board does not agree with MPI's argument that they serve the same purpose. IRs are far more significant in terms of building a full and unbiased record and must be broader in scope to permit the proper determination of the Application.

In addition, the Board does not accept MPI's submission that the purpose of IRs in Rules 14 to 16 ought to be narrowly interpreted to permit only information requests which may provide a party with a satisfactory understanding of the "material filed". The Rules clearly provide that the purpose of IRs is to permit a satisfactory understanding "of the matters to be considered" in the Application.

With respect to MPI's submissions on the reasonableness of MPI's decision-making and investment strategy, the Board does not accept the approach MPI has advocated. First, the Board does not accept that the Board should adopt and apply a standard of review to MPI's decision-making which mirrors that used by the courts in the review of administrative decisions. The standard of review in the administrative law context presumes a deferential standard of reasonableness or, in limited instances, correctness. However, it has long been established that a prudence evaluation is the appropriate method of review for regulators when assessing whether or not the rates requested are just and reasonable. While reasonableness is certainly a factor in a prudence evaluation, it is a broader concept of reasonableness than that applied in the context judicial review by the courts of administrative decisions.

In essence, MPI argues that there ought to be a presumption of prudence. Such a presumption, however, would amount to an abdication of the Board's duty to assess the prudence of the Corporation's decision-making to the extent those decisions affect rates.

The Board does not agree with MPI's submission that in order for the IRs at issue to be answered, the onus is on CAC to prove or provide evidence that there was some credible deficiency in the inflation forecast used by Mercer in the preparation of the Mercer ALM Study. As stated above, the onus is on MPI throughout to prove that the rate requested is just and reasonable. This is not to say that Interveners bear no onus to justify an IR. The party making the IR bears the onus of satisfying the Board that the IR falls within the scope of the Rules, and is of sufficient probative value to justify a response.

In the circumstances of the present case, the Board has determined that the information requested in the IRs at issue is relevant and material, and would be of probative value. The Board notes as well that the information requested has been a key element of CAC's previous challenges to MPI's investment policy. The information requested is necessary to continue the examination of the issue.

The Board does not accept MPI's contentions that the granting of CAC's Motion implies that decisions of Mercer, MPI's Board of Directors and its Investment Committee were not reasonable, or calls into question the competency of the individuals involved. The Board makes no finding in that regard at this time; the Board is simply providing for a

complete and unbiased record to allow the GRA to be satisfactorily understood and fully examined.

The Board does share MPI's concern as to the additional costs associated with providing responses to the IRs in question. While CAC acknowledges that it may be able to provide some analysis in response, the Board accepts CAC's argument that such evidence would result in further study and analysis by MPI, potentially utilizing further analysis from Mercer at additional cost. Accordingly, on balance, the Board is of the view that although the costs are not insignificant, compelling responses to the IRs will not be cost-inefficient.

The Board also notes that the direction in Order 162/16 and Order 130/17 was to obtain an ALM Study which addressed each of the 18 recommendations made by Mr. Viola during the 2017 GRA. Although MPI initially stated that it was logistically impossible to provide such a study in time for the 2018 GRA, it embarked upon the process in an accelerated fashion during the 2018 GRA without prior consultation or input from the Board or CAC in respect of the scope of that study or any clarification of Mr. Viola's 18 recommendations.

The IRs in question raise issues and request modelling based on some of the same or similar criticisms contained within Mr. Viola's 18 recommendations. As MPI has not obtained or carried out the analysis contemplated by these IRs, CAC's rationale claims that the Mercer ALM Study does not provide a complete response to Mr. Viola's recommendations. The Board notes that such consultation prior to obtaining the Mercer

ALM Study may well have ameliorated the issues and costs associated with now providing responses to the IRs in question.

Accordingly, the Board hereby grants CAC's motion and orders that MPI file and serve responses to IRs CAC (MPI) 1-84(f) and 1-85(g), on or before September 24, 2018. CAC shall file and serve any Second Round IRs arising out of the responses to IRs CAC (MPI) 1-84(f) and 1-85(g) on or before September 26, 2018. MPI shall file and serve the Responses to Second Round IRs arising out of CAC (MPI) 1-84(f) and 1-85(g) on or before October 3, 2018.

3.0 IT IS THEREFORE ORDERED THAT:

- 3.1 The Motion filed by the Consumers' Association of Canada (Manitoba) Inc. (CAC) for an Order requiring MPI to file responses to Information Requests CAC (MPI) 1-84(f) and CAC (MPI) 1-85(g) is hereby granted.
- 3.2 MPI shall file and serve responses to CAC (MPI) 1-84(f) and 1-85(g), attached hereto as Appendix A, on or before September 24, 2018.
- 3.3 CAC shall file and serve any Second Round Information Requests arising out of the responses to IRs CAC (MPI) 1-84(f) and 1-85(g) on or before September 26, 2018.

- 3.4 MPI shall file and serve responses to Second Round Information Requests arising out of the responses to IRs CAC (MPI) 1-84(f) and 1-85(g) on or before October 3, 2018.

THE PUBLIC UTILITIES BOARD

"Robert Gabor, Q.C."

Chair

"Darren Christle"

Secretary

Certified a true copy of Order No. 124/18
issued by The Public Utilities Board



Secretary

APPENDIX A

CAC (MPI) 1-84(f)

f) **More Detailed Analysis for Real Scenarios:** Was the same “stepped” analysis that was performed using the Nominal Liability Benchmark (e.g. pages 1,749 to 1,753) also performed using the Real Liability Benchmark?

- i. If so, provide the analysis and commentary (at least for Basic and Pensions).
- ii. If not, could a similar analysis and commentary be provided, showing the effect of including RRBs (“minimally” constrained)? (at least for Basic and Pensions).

CAC (MPI) 1-85(g)

g) Can Mercer show efficient frontiers, similar to the Capital Market Line shown above, except that risk is to be defined to take into account liabilities (surplus, not assets only), and the “risk-free” asset is the Minimum Risk Portfolio (**Real** Liability Benchmark, **not Nominal** Liability Benchmark, and not TBills)?

- i. The analysis should show the effects of allowable leverage **for fixed income assets only** (e.g. bond overlays, including RRBs). Other constraints can be added in a “stepped approach”, starting from the “minimally constrained” scenario, in the same way such “steps” were shown on pages 1,749 to 1,753 of the GRA to illustrate the effects of adding new asset classes.

ii. The steps should include, at a minimum, the imposition of various constraints that were actually imposed, directly or indirectly, or which would illustrate the return/risk tradeoffs arising from various “steps” taken (or decisions made) as listed below:

- 1) Set 0% maximum in RRBs
- 2) Restrict the weight to the “final MPI recommended” weight, rather than the global market cap, in three (3) **individual steps** for:
 - (1) Canadian Equity
 - (2) Emerging Markets Equity
 - (3) Other Equity

iii. The analysis should clearly show a portfolio (“Privates + ACWI”) that consists of 0% fixed income, with a private/public split below:

- 1) Real estate, infrastructure, and private equity using MPI’s recommended weights.
- 2) Public equity in Canada, US, Emerging Markets, and other regions at their global market cap weights (e.g., All Country World Index Equities (ACWI)).

iv. Mercer’s “Observations” would facilitate the interpretation of results, as would Mercer’s “Asset Mix Options” and “Expected Surplus Growth”, similar to the observations and other reporting Mercer provided on pages 1,749 to 1,753 and 1,790 to 1,793 respectively of the GRA.

v. The scope of the above analysis could be limited to Basic and Pension.