Order No. 159/18

MANITOBA PUBLIC INSURANCE CORPORATION (MPI OR THE CORPORATION): COMPULSORY 2019/2020 DRIVER AND VEHICLE INSURANCE PREMIUMS AND OTHER MATTERS

December 3, 2018

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

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EXECUTIVE SUMMARY

The Public Utilities Board (Board or PUB) hereby orders an overall 1.8% rate increase to Basic compulsory motor vehicle premiums (Basic or Basic Insurance) for the 2019/20 insurance year, effective March 1, 2019, for all major classes combined. There will be no change in permit and certificate rates, vehicle premium discounts, service and transaction fees, or fleet rebates or surcharges.

The Board's order for a rate increase of 1.8% results from the Board's approval of rates calculated in accordance with Accepted Actuarial Practice in Canada, based on a Naïve interest rate forecast (as defined below), taking into account actual interest rates as at September 30, 2018, and the inclusion of a Net Capital Maintenance Provision.

The Board's order for an increase of 1.8% does not mean that rates for all motorists within each major vehicle class increase by that amount. Rates paid by individual policyholders within each Major Class will be determined based on their driving record, the kind of vehicle (make and model and year) registered, the purpose for which the vehicle is driven, and the territory in which the policyholder resides. Policyholders' premiums will also be affected by actual claims experience.

The Board’s approval of the use of the Naïve interest rate forecast is for this year only, and applies for rate-setting and target capital purposes. In the 2020 GRA, the Corporation will be required to report back on its tracking of interest rate movements and how this has informed its decision on interest rate forecasting. In reaching its decision on interest rate forecasting, the Board has moved from its position on interest rate forecasting as set out in Order 130/17. However, the Board finds that the Naïve interest rate forecast represents a best estimate for rate-setting purposes, if it reflects the evidence led on the latest available market information at the time of the hearing, as was the case in this GRA. The Board has considered all of the evidence with respect to interest rate forecasting, and bases its decision on the acknowledged and consistently evident uncertainty inherent in forecasting interest rates. The Board finds that building that uncertainty into the rate indication is not reasonable for ratepayers at this time.

In Order 130/17, the Board recognized MPI's need to protect against the natural depletion of Basic's capital position, and found that a Capital Maintenance Provision (CMP) could be considered a legitimate necessary Basic expense for rate-setting purposes. The Board notes that in each of the last four years, the Corporation has had to transfer funds from the Extension line of business to the Basic Rate Stabilization Reserve. While it was premature in Order 130/17 for the Board to base its decision on the inclusion of a CMP, the Board directed that a Technical Conference be held on the issue, and any findings therefrom be incorporated into this General Rate Application (GRA). A Technical Conference on the CMP was held on March 2, 2018. MPI reported on the Technical Conference in this GRA and incorporated information therefrom into its proposal for a Net Capital Maintenance Provision (Net CMP). In this GRA, the Board heard from MPI that it is considering an overall capital management plan for the Corporation, which would include the Net CMP. The Board will consider this approach when it has further information. While it is prepared to include the Net CMP in the rate in this GRA, the approval of the Net CMP is for this GRA only. In the next GRA, the Corporation must come forward with its capital management plan for the entire Corporation. Further, MPI shall be required to participate in a Technical Conference on a capital management plan, prior to the 2020 GRA, such that the information from the Technical Conference shall be included in the 2020 GRA.

By Order 11/18, issued on January 15, 2018, the Board granted to MPI approval of its rates for Vehicles for Hire (VFH), on an interim basis only, recognizing the urgency of the need for rates to be in place when *The Local Vehicles for Hire Act* was to come into force on February 28, 2018. In Order 11/18, the Board issued a number of directives to MPI, with the expectation that MPI would be in a position to provide further information and experience following the interim approval of the VFH rates. In this Application, the

Corporation applied for final approval of the VFH rates, which were approved in Order 11/18. The Board has approved the VFH rates on a final basis.

In the 2018 GRA, the Corporation applied for an increase to the premiums on the demerit side of the Driver Safety Rating (DSR) system. The Board approved the Corporation's application in that regard but directed the Corporation to undertake further work toward the implementation of more actuarially sound DSR premiums and vehicle premium discounts. In this Application, the Corporation provided an update on its progress in that regard and reported that its work will involve public consultation efforts, along with further investigation and analysis of alternative rating models. It reported that it anticipates that by the 2020 GRA, it will be in a position to report on the results of its public consultation efforts and its preliminary research. The Board has directed that the Corporation provide an update on its progress in that regard in the 2020 GRA.

The Board continues to support the Corporation's cost containment efforts, including the steps taken to reduce operating expenses and optimize staffing levels. The Board finds that the Corporation is continuing to take positive steps towards containing its costs.

In this Application, the Board received the Corporation's 2018/19 Information Technology (IT) Strategy, and heard significant evidence on the issue of IT. IT has been of concern to the Board in recent years' Applications. The Board is encouraged by the Corporation's continued efforts to continue to reduce reliance on IT consultants and reduce the number of IT staff overall.

In Order 130/17, the Board commented that it expected that MPI's new Value Management Process would bring in valuable controls and contribute to better business process management in IT. The Board also expressed concern in Order 130/17 that the Corporation had not disclosed the costs to operate the Physical Damage Re-Engineering (PDR) program, which the Board viewed as a critical component in assessing the costs and benefits associated with the program.

The information filed in this Application made clear that the Board's concerns about IT spending were well-founded, particularly with respect to the PDR program. While in the 2018 GRA, the evaluation of PDR prepared by Gartner concluded that it had a net present value of $13.7 million, Gartner's evaluation in this Application concluded that the program has a net present value of ($49.9) million. This dramatic change was the result of MPI providing Gartner with information that had previously been withheld from Gartner about program costs. Given the history of the PDR program, the Board finds that it is important that the Corporation continue to evaluate and report on the program and therefore the Board has directed that in the 2020 GRA, the Corporation file an update, prepared by Gartner, to its 2018 PDR Program Evaluation.

Notwithstanding the Board's concern about the PDR program, the Board finds that the information filed by MPI in this Application with respect to IT was thorough and comprehensive. The Board acknowledges the openness with which the Corporation provided information on IT in this Application, and is of the view that the Corporation has demonstrated progress in its efforts to rein in spending on IT, and to make strategic IT investments in the future. The Board anticipates receiving information from the Corporation in the 2020 GRA as to the progress it has made in the implementation of the Value Management Process and the IT Strategy. The Board expects the Corporation to show that its new approach to investing in IT is producing results. Given the Board's ongoing interest in IT, the Board has directed that the Corporation provide updates on all Business Transformation Office-managed IT projects in the 2020 GRA. The Board has also directed that an ongoing dialogue take place between it and MPI in advance of the 2020 GRA, with respect to progress on the Legacy Modernization project, any business cases created for the initiative, and the establishment of higher-level key performance indicators. The Board has also directed that in the 2020 GRA, the Corporation provide an update of its progress on the Legacy Modernization initiative, file any business cases created for the Legacy Modernization initiative, and any higher-level key performance indicators.

The Board finds that the Corporation continues to rely much more heavily on consultants than do its peers in the area of IT. The Board appreciates that the Corporation has challenges in reducing the ratio of consultants to staff given the non-solicitation clauses in its contracts with vendors. The Board understands that these contracts provide a valuable service to MPI, but is concerned that MPI could become overly dependent on vendors. The Board has therefore directed the Corporation, in the 2020 GRA, to report on its progress in reducing the ratio of IT consultants to staff, and in managing relationships with IT vendors.

The Board did not receive an updated Asset Liability Management (ALM) study in the 2018 GRA. The Board was able to review the ALM study, prepared by Mercer Canada, in depth this year. The Board also heard about MPI's decision to segregate its investment portfolio into five distinct portfolios, as a result of the Mercer ALM study recommendations.

When it comes to the Corporation's overall investment strategy, the Board recognizes that its oversight role does not extend to directing the Corporation as to the particulars of its portfolio management. The Board finds that the Corporation has selected from a range of reasonable options for its portfolios as a result of the Mercer ALM study.

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. First, the Board has directed the Corporation to run shadow portfolios for the Basic and Pension portfolios, effective March 1, 2019, with the inclusion of Real Return Bonds as part of an optimal bond portfolio mix. Second, the Board has directed the Corporation to immediately engage Mercer to run shadow portfolios for Basic and Pension effective March 1, 2019, without the constraints imposed by the Corporation. Reports on the results of the shadow portfolios are to be filed in the 2020 GRA. As well, the Board has directed the Corporation to file a post-implementation review of its ALM strategy. The Board will review the shadow portfolios and the post-implementation review in the 2020 GRA. 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.

The Board again deliberated on the appropriate level of and methodology for setting MPI's Rate Stabilization Reserve (RSR) and Total Equity target capital range. The purpose of the RSR is to protect motorists from rate increases that would otherwise have been necessary due to unexpected variances from forecasted results and due to events and losses arising from non-recurring events or factors.

In the 2018 GRA, the Corporation requested a Basic Total Equity target capital range of $201 million to $438 million, and the Board ordered that the range be $180 million to $325 million. In this GRA, the Board has approved a Basic Total Equity target capital range of $140 million to $315 million, based on the results of the Corporation's target capital analysis updated to reflect market interest rates as of the end of September 2018, using the Naïve interest rate forecast. The Board directs, however, that in the 2020 GRA, the Dynamic Capital Adequacy Testing base scenario forecast must fully reflect any expected capital adjustments arising from the thorough capital management plan, which the Board has directed to be presented in the next GRA.

The Board acknowledges the Corporation's view that adequate capital in the RSR is required in order to permit MPI to provide stable and predictable Basic rates, and recognizes the risks associated with Basic being undercapitalized, leaving MPI and ratepayers in a vulnerable position in the event of severe adverse events. The Board recognizes, however, that considerable work has been devoted and progress made over many previous GRAs and through a collaborative process with stakeholders on the issue of the appropriate methodology to be used to establish the Basic Total Equity target capital range. The Board is concerned, however, that it is receiving the same positions from the parties year after year and would like to avoid re-visiting the same arguments. The Board would prefer to establish a standard so that the issue can be determined for a longer period than one year, and then the results of a standard methodology can be evaluated. To this end, the Board intends to engage the services of an independent consulting actuary with experience in target capital analysis to engage stakeholders in discussion to understand their preferred approaches to Basic target capital analysis and prepare expert evidence for the 2020 GRA, setting out the expert's opinion on best practices in that regard.

The Board's approval of the Corporation's target capital methodology in this Order should not be seen as a specific endorsement or rejection of any particular approach to the Basic target capital analysis going forward, as the Board intends to examine this issue further, following receipt of the independent consulting actuary's expert evidence in the 2020 GRA.

The Board has, in past Orders, expressed the view that the Corporation's non-compulsory Extension line of business should be regulated. One of the reasons for this is the Board's concern that the level of Basic Total Equity could be depleted at a time when the Extension line of business contains significant reserves. However, the Board's concern is alleviated somewhat given that the Corporation intends to bring forward a capital management plan with rules for transfers from other lines of business. The Board will withhold comment in this Order that it be given the jurisdiction to regulate Extension, and will await the review of the capital management plan at the next GRA.

In Order 130/17, in providing its rationale for directing a wide-ranging Technical Conference on road safety to take place in early 2019, the Board commented that road safety and loss prevention is a complex, multi-faceted area involving multiple stakeholders. The Board directed that the issue of road safety would not be reviewed in the same level of detail in this GRA as it had in prior years. Therefore, in the public hearings for this GRA, the Board heard evidence on the Corporation's road safety expenditures, but not on specific initiatives and programs. The Board expects that all aspects of road safety will be thoroughly reviewed in the forthcoming Technical

Conference and looks forward to receipt of the information shared in the Technical Conference in the 2020 GRA.

In this GRA, the Board implemented a process change whereby the issues to be reviewed were identified and approved by the Board on an interim basis prior to the preparation of the GRA, and then finalized after the Pre-Hearing Conference. The Board will seek comments from the parties as to whether this process was beneficial in focusing the areas to be reviewed in detail in this Application.

The Board has made a number of directives in this Order. The Board hereby directs the Corporation to file with the Board, on or before April 1, 2019, a report advising as to the status of its compliance with each of the directives contained herein.

This Order reflects the Board's findings on matters which arose over the course of the proceeding through oral testimony and documentary evidence. Public access to the full transcripts of the public portions of the hearing, including cross-examination, presentations and closing statements, as well as documentary evidence are available on the Board's website (www.pub.gov.mb.ca).

Interested parties may also review MPI's Annual Report and quarterly financial statements on MPI's website (www.mpi.mb.ca).

1. THE RATE APPLICATION

1.1. Procedural History

On June 15, 2018, the Corporation filed with the Board the 2019 General Rate Application (GRA or Application) seeking approval of premiums for Basic, for the fiscal year commencing March 1, 2019 and ending February 29, 2020. The Application was filed in accordance with the provisions of *The Crown Corporations Governance and Accountability Act* and *The Public Utilities Board Act*.

Prior to the filing of the Application, the Board issued Interim Procedural Order 61/18, in which it approved an Issues List for the Application, on a preliminary basis. The Board's intention with this procedure was to streamline the process in this GRA. In doing so, the issues in the Issues List were placed in one of three categories: issues to be considered in the scope of the GRA in the normal course; issues requiring more detailed examination in the 2019 GRA; and issues deferred from the 2019 GRA to future applications, or which would be the subject of a technical conference or another process.

Following the pre-hearing conference which took place on June 25, 2018, by Order 82/18, dated June 29, 2018, the Board approved the Issues List on a final basis, and granted intervener status to the following parties:

- Consumers' Association of Canada (Manitoba) Inc. (CAC);
- Coalition of Manitoba Motorcycle Groups (CMMG); and
- Canadian Automobile Association (CAA).

While CAA was granted Intervener status, it advised the Board prior to the commencement of the public hearings that it would not be appearing, given that the Board did not intend to review the issue of road safety in these proceedings, having deferred it to a Technical Conference to take place in early 2019.

Ten days of public hearings took place, during which the Board heard evidence from witnesses appearing on behalf of MPI and CAC, and submissions from presenters. The public hearings began on October 15, 2018, and concluded on October 31, 2018.

1.2. The Application

The Corporation reported that in 2018, the Board of Directors adopted a new Corporate Mission Statement: *Exceptional coverage and service, affordable rates and safer roads through public auto insurance*. The Corporation advised that the new mission statement would guide its actions going forward.

In addition, MPI defined new corporate values, articulating how it will fulfill its mission:

> *As a public auto insurer, we hold ourselves accountable to all Manitobans to deliver value by fostering a culture of excellence. We achieve this through our four core values:*
>
> - *Doing What's Right: We act with integrity and accountability. We strive to be open and transparent*
> - *Investing in People: We empower our employees to provide excellent service. We work together with business, community and road safety partners to fulfil our mission.*
> - *Striving for Excellence: We provide exceptional coverage and service. We adapt to meet evolving customer and industry needs, focusing on continuous improvement.*
> - *Providing Value to Manitobans: We maintain affordable rates and ensure accessible coverage. As a public auto insurer, fiscal responsibility is at the forefront of everything we do.*

The Corporation explained that everything contained within the Application was based on carrying out the mission statement.

The Board's jurisdiction applies to rate-setting for MPI's Basic insurance line of business, and not to MPI's other optional lines of business, Extension and Special Risk Extension (SRE).

The Corporation requested an overall 2.2% increase in Basic vehicle premium revenue (including Vehicles for Hire rates for service), comprised of a 0.1% increase to the break-even cost of policies in accordance with Accepted Actuarial Practice in Canada, and a

2.1% increase for a Net Capital Maintenance Provision, to maintain the Corporation's capital position through the rating year, as measured by the Minimum Capital Test.

The vehicle premium rates put forward by MPI included experience-based rate adjustments largely ranging from -15% to +15%, based on adjustment rules. In addition, the Corporation combined classification offsets for all vehicles except off-road vehicles, to achieve revenue neutrality and implemented rate group, rate line and classification changes for 2020.

According to the Corporation's rate design, the change to Basic compulsory motor vehicle premiums for each major vehicle class at the rate requested by MPI would have the following average vehicle premium changes:

Major Class	**2.2% Experience Rate Change**
Private Passenger	2.4
Commercial	2.4
Public	0.6
Motorcycle	3.1
Trailers	(4.7)
Off-road vehicles	(20.0)
Total	**2.2**

Rates paid by individual policyholders within each Major Class are determined by their driving record, the kind of vehicle (make and model and year) registered, the purpose for which the vehicle is driven and the territory in which the policyholder resides. Policyholders' premiums are also affected by actual claims experience. As a result, some individuals would experience increases in insurance rates, and others would experience decreases.

The Corporation sought no change to permit and certificate rates, vehicle premium discounts, service and transaction fees, or fleet rebates or surcharges.

The Corporation characterized the rate applied for as stable and the result of the implementation of best practices and prudent fiscal management, leading to stable, affordable rates. The Corporation stated that it is pursuing its mandate by focusing on smaller incremental increases, which support long term stability. The Corporation maintained that it had brought a rate request that is just and reasonable. Although the Corporation did not seek to amend its Application, it advised the Board that it would endorse having the Application varied by the Board, to reflect the actual Government of Canada 10-year bond yield as at September 30, 2018, of 2.43%.

A history of the percentage rate changes applied for by the Corporation and ordered by the Board is as follows:

Year	Applied For	Ordered
2019/20	2.2	1.8
2018/19	2.7	2.6
2017/18	4.3	3.7
2016/17	0.0	0.0
2015/16	3.4	3.4
2014/15	1.8	0.9
2013/14	0.0	0.0
2012/13	-6.8	-8.0
2011/12	-4.0	-4.0
2010/11	0.0	0.0
2009/10	-1.0	-1.0
2008/09	0.0	0.0
2007/08	-2.6	-2.6
2006/07	0.0	0.0
2005/06	0.0	-1.0
2004/05	2.5	3.7
2003/04	0.0	-1.0
2002/03	-1.2	0.0
2001/02	0.0	0.0

There have also been $597 million in premium rebates ordered by the Board over the last 17 years, as follows:

Year	Total ($ millions)	Percent of Premiums
2011	$336	45.0%
2008	$63	10.0%
2007	$60	10.0%
2006	$58	10.0%
2001	$80	16.6%

2. PROGRAM REVENUE

2.1. Basic Revenue Requirement

The Corporation derives revenue from four main sources to fund Basic: vehicle premiums; driver premiums; service and transaction fees; and investment income. The Corporation's projected operating results for 2019/20 and 2020/21, the years affected by the applied for 2.2% rate increase, are as follows:

	2019/20 Applied for Rate Per Application ($ millions)	2020/21 Projection Per Application ($ millions)
Motor Vehicle Premiums	**$1,054.6**	**$1,109.2**
Drivers' Licence Premiums	**69.9**	**71.9**
Reinsurance ceded	**(11.4)**	**(11.7)**
Total Net Premiums Earned	**1,113.1**	**1,169.4**
Investment Income	**82.1**	**84.9**
Service Fees & Other Revenues	**25.8**	**27.6**
Total Earned Revenues	**$1,221.0**	**$1,281.9**
Claims Incurred	**$900.2**	**$950.7**
Claims Expenses	**135.4**	**139.2**
Road Safety Expenses	**12.7**	**12.8**
Operating Expenses	**73.6**	**76.3**
Commissions	**42.7**	**44.8**
Premium Taxes	**33.7**	**35.4**
Regulatory/Appeal expenses	**4.8**	**5.0**
Total Claims and Expenses	**$1,203.1**	**$1,264.2**
Net income (loss) – Basic	**$17.9**	**$17.7**

The projected results were based on an assumed Naïve interest rate forecast (assuming no changes in current interest rates) as at the time of the filing of the application, which MPI requested the Board utilize for rate-setting purposes. The Corporation took the position that the 50/50 interest rate forecast (representing the midpoint between the Naïve and the Standard Interest Rate Forecast), which the Board directed the Corporation to use for rate-setting and target capital purposes in the 2018/19 GRA, not be used in this Application.

In the course of the public hearings, at the request of the Board, the Corporation filed an update to its forecast based on interest rates as at September 30, 2018. As a result of this updated forecast, Basic's projected net income in 2019/20 would increase from a net income of $17.9 million, to a net income of $143.0 million, and its net result in 2019/20 would be a net income of $18.8 million.

2.2. Vehicle Premiums

Total written premiums earned are forecast to be $1,019.3 million in 2019/20, and to grow to $1,085.1 million in 2020/21. The revenue earned by Basic in respect of vehicle premiums may change due to four factors: rate changes as ordered by the Board; growth in the number of vehicles in the fleet (Volume Factor); changes in the average premium per vehicle caused by factors other than rate changes, such as the gradual upgrade of the fleet as older vehicles are replaced with newer ones (Upgrade Factor); and the impact on vehicle insurance premiums from changes in the average Driver Safety Rating (DSR) level of registered vehicle owners (DSR Upgrade Factor).

The Volume Factor is based upon the historical growth rate of *The Highway Traffic Act* (HTA) vehicles only (including the private passenger, commercial, public and motorcycle major classes, and excluding trailers and off-road vehicles), which account for 76% of the fleet and over 98% of MPI's total Basic written premiums. MPI is forecasting Volume Factor growth to be 1.50% for each of 2019/20, 2020/21 and beyond. The Corporation is forecasting Upgrade Factor growth to be 2.54% for 2019/20, 2.58% for 2020/21, and 2.51% for 2021/22.

The combined impact of the forecast premium revenue growth due to Volume Factor, Upgrade Factor and DSR Upgrade Factor is as follows:

Year	Vehicle Upgrade Factor	DSR Upgrade Factor	Total Upgrade Factor	Volume Factor	Total Volume & Upgrade Factor
2017/18 (Actual)	2.32%	0.08%	2.40%	1.44%	3.84%
2018/19	2.45%	(0.06%)	2.39%	1.50%	3.89%
2019/20	2.45%	0.09%	2.54%	1.50%	4.04%
2020/21	2.45%	0.13%	2.58%	1.50%	4.08%
2021/22	2.45%	0.06%	2.51%	1.50%	4.01%
2022/23	2.45%	0.09%	2.54%	1.50%	4.04%

2.3. Driver Premiums

The level of Driver Premiums paid by licensed drivers is based on the DSR scale. Until Order 130/17, issued after the 2018 GRA, the DSR scale ranged from $15 at level 15 to $2,500 at level -20. In the 2018 GRA, the Corporation applied, and the Board approved, an increase to driver premium revenues by $17.5 million, by increasing the driver premiums to the demerit side of the DSR scale only, such that the scale now ranges from $15 at level 15 to $3000 at level -20.

The Corporation reported in this GRA that the estimated annualized impact of the increase in DSR demerit premiums is $16.8 million, with the increase in revenue associated with the higher DSR premiums having been approximately $8.4 million through the second quarter of fiscal year 2018/19.

Driver Premiums are forecast to be $70.9 million in 2019/20, and to increase to $72.9 million in 2020/21. The forecast considers five components: the number of earned driver units by DSR level; the expected movement of drivers on the DSR scale; the average number of earned driver units by DSR level; the driver premiums by DSR level; and a percentage reduction in drivers' premiums from appeals.

2.4. Investment Income

The Corporation's funds available for investment are primarily the assets supporting the unearned premium reserves and unpaid claims reserves. The funds within the portfolio support both the payment of accident claims and the pension obligations of the Corporation. The Corporation had short and long-term investments, including cash and equities, for the Basic Line of Business totalling $2.4 billion in 2017/18, which is forecast to grow to over $2.5 billion by 2022/23.

Investment income earned from the Corporation's investment portfolio reduces the revenue that it is required to collect through premiums. The Corporation's investment income is allocated to the Basic Insurance line of business based on a monthly averaging of the funds available within each division. MPI realized $134.8 million in investment income in 2017/18, of which 86.28%, or $116.3 million, was allocated to Basic. This was a $33.4 million improvement from the $82.9 million income allocated to Basic in 2016/17.

Based on the September 30, 2018 Naïve interest rate forecast, MPI is forecasting investment income allocated to Basic of $171.4 million in 2018/19, $84.9 million in 2019/20 and $88.3 million in 2020/21. Further discussion on MPI's investment portfolio and returns is found in Section 7 of this Order.

2.5. Service Fees and Other Revenues

The Corporation reported that service fees and other revenues account for approximately 2.0% to 2.5% of annual revenues for the Basic program, and that there are approximately 25 to 30 service fees and revenue types allocated to Basic. These fees and other revenues include revenue from quarterly and monthly pre-authorized payment plans, late payment fees, motor vehicle transaction fees, dishonoured payment fees, pre-authorized default fees and other fee-related items. Some Basic Service Fees are collected by MPI on behalf of the Government.

Basic projects income from Service Fees and Other Revenues of $23.8 million in 2018/19, $25.8 million in 2019/20, and $27.6 million in 2020/21.

In the 2018 GRA, the Corporation advised that a Basic Service Fees review was under way and close to completion. The Board, in Order 130/17, directed the Corporation to report on the results of the Service Fees Review in this Application. In this Application, the Corporation reported that it had completed the Service Fee Review in 2017/18, which consisted of a jurisdictional scan, comparing its service fees to those of the Insurance Corporation of British Columbia (ICBC), Saskatchewan General Insurance (SGI), as well as with those of Manitoba Hydro. The Corporation determined that no changes were yet required, explaining that it would be premature to seek changes to the Basic service and transaction fees prior to it knowing the outcome of any changes that might be made by the Government of Manitoba to *The Drivers and Vehicle Act* service fees.

3. RATE INDICATIONS

3.1. Accepted Actuarial Practice in Canada

Ratemaking in accordance with Accepted Actuarial Practice in Canada (AAP) involves determining the indicated rate level such that, for a given future rating year, the present value of expected future revenue cash flows (e.g., premiums and fees) is equal to the present value of expected future expense cash flows (e.g., claims, adjusting expenses and non-claims-related costs, including any profit provision).

In Order 162/16, the Board approved the rate indication prepared by the Corporation based on AAP, and directed that the Corporation follow AAP as the basis for its rate indications in future rate applications. The Corporation commenced using AAP as the basis for its rate indications in the 2018 GRA, and continued to do so in this Application.

In Order 130/17, the Board ordered that a Technical Conference be held prior to this GRA, the scope of which included seeking consensus on the following matters relating to rate-setting in accordance with AAP:

- Basing the cash flow discount rate assumption on the expected new money rate averaged over the full proposed rating year rather than as at the start of that rating year;
- Segregating the pension liabilities and the related supporting investment assets from the determination of the cash flow discount rate and the expected return on investment assets supporting Basic Total Equity; and
- Improving recognition of investment fees in the determination of the cash flow discount rate and the expected return on investment assets supporting Basic Total Equity.

The Application addressed all but the last of these three matters either directly or as a consequence of the Corporation's new Asset Liability Management strategy, which is discussed in detail later in this Order. The Corporation noted an oversight, that it did not address the last of these three matters in this Application, which will be properly addressed in future GRAs.

The Corporation's estimate of its overall rate requirement is sensitive to the methods and assumptions used in its derivation. In the Application, the basis for the Corporation's rate proposal is an AAP overall rate indication comprised as follows:

Break even overall rate indication	+0.1%
Impact of expected return on investment assets supporting Basic Total Equity	-1.2%
Impact of Capital Maintenance Provision	+3.3%
Total overall rate indication	**+2.2%**

The underlying analysis for this rate indication used a Naïve interest rate forecast (which assumes no change in market interest rates going forward), based on market interest rates as of the end of February 2018. The assumed AAP new money cash flow discount rate based on this interest rate forecast was 3.21%.

In the course of the public hearings, the Corporation provided an update to its interest rate forecast to the end of September 2018, which increased the assumed AAP new money cash flow discount rate by 19 basis points, up to 3.40%. This, in turn, reduced its estimate of the total overall rate indication to an increase of 1.8%. In its testimony, the Corporation acknowledged the relevance of recognizing this forecast update and the resulting impacts on assumptions and the overall rate indication.

3.2. Vehicle Classification System

The Corporation classifies vehicle risk by considering insurance use, rating territories, and rate groups. Insurance use classifications categorize vehicles by the nature of the vehicle and its intended insurance use, which now includes rates for Vehicles for Hire, further to Order 11/18. There have been no changes in insurance use classifications in this Application.

Vehicles are assigned to one of five territories in Manitoba, including a commuter territory in the areas adjacent to the City of Winnipeg, based on the primary residence of the registered vehicle owner. There have been no changes to the rating territories in this Application.

For passenger vehicles and light trucks, the Corporation uses the Canadian Loss Experience Automobile Rating system (CLEAR) promulgated by the Insurance Bureau of Canada (IBC), which amalgamates data from Canadian insurers and creates rate groups (up to 99) by vehicle make, model and model year, for each of collision, comprehensive and accident benefits coverages. The Corporation combines those rate groups to produce a smaller number of rate groups for the single Basic coverage package. It then adjusts for its own experience by rate group, thereby re-calibrating the CLEAR indications.

The Corporation reported that for 2019/20, the following changes were applied:

- CLEAR rated passenger vehicles and light trucks;
- Rate group changes for heavy trucks and heavy-rated–as-light trucks; and
- Rate line changes for passenger vehicles, light trucks, heavy trucks, motorcycles, mopeds and mobility vehicles, motorhomes, trailers, and buses.

3.3. Interest Rate Forecasting

This Application included considerable discussion of the appropriate basis for interest rate forecasting, as in previous years. The Naïve interest rate forecast, which was proposed by the Corporation, assumes no change in market interest rates going forward from the starting forecast date (in the Application, filed the end of February 2018). The Standard Interest Rate Forecast (SIRF) bases the assumed forecast on a consensus of independent forecasts from the major Canadian banks, plus Global Insight, an economics organization that specializes in economic forecasting and market outlook. The compromise between these alternatives is the 50/50 interest rate forecast, which adopts the average of the Naïve and SIRF at each point over the forecast period. It was first formally introduced by MPI in the 2017 GRA.

In Order 130/17, the Board directed that the 50/50 interest rate forecast be used for rate-setting and target capital purposes.

In support of its use of the Naïve forecast in the Application, the Corporation noted that it is required to base its rate application on best estimates, and that for this Application, the Corporation's management and Board of Directors continued to maintain that the Naïve interest rate forecast is the best estimate. MPI defended its position with an analysis of the standard error (actual vs. forecast) of the competing forecasts (which speaks to the forecast efficiency), from the 2005 GRA up to the 2018 GRA. This analysis showed that the Naïve forecast had the lowest standard error relative to either the SIRF or the 50/50 forecast.

The Corporation also undertook a paired sample t-test on the sample mean, to test if the 50/50 forecast and the Naïve forecast produced a statistically significant difference in results. This analysis indicated that the Naïve forecast produced a forecast with less bias than, and with a statistically significant difference from, the 50/50 forecast at the 99th percentile.

The Corporation also cited the evidence of its external appointed actuary, that a Naïve forecast is the most common approach in the Dynamic Capital Adequacy Testing (DCAT) base scenario financial forecasts his firm reviews, and that it constitutes a reasonable base forecast because of the uncertainty in forecasting how interest rates may change. The external actuary acknowledged that this evidence was provided in a DCAT context, and not a rate-setting context.

MPI's adoption of the Naïve forecast reflects its reluctance to "betting" on how interest rates will move in the near term.

In MPI Exhibit #26, filed in the course of the public hearings, the Corporation provided an updated alternative overall rate indication based on a 50/50 forecast, reflecting market interest rates as of the end of September 2018. Relative to the 1.8% overall rate indication noted above and based on the Naïve forecast as at the same date, the alternative overall rate indication would fall to 1.0% under the 50/50 forecast.

3.4. Capital Maintenance Provision

3.4.1. Basic Concept

The concept of a Capital Maintenance Provision (CMP) was first reviewed before the Board in the 2018 GRA, as a possible means of recognizing in the rate-setting process the expected growth of Basic's risk profile and depletion of Basic's capital position that naturally arises from the expected growth of Basic's actuarial liabilities and its supporting investment portfolio.

In Order 130/17, the overall rate change approved by the Board was based on permitting the expected return on investment assets supporting Basic Total Equity to be retained by Basic, and not passed through to ratepayers in the form of lower rates. This approval was temporary pending further examination of the CMP concept. Permitting the expected return on investment assets supporting Basic Total Equity to be retained by Basic acts, in effect, as a proxy for the CMP.

In Order 130/17 the Board also directed that a Technical Conference be held to seek a consensus approach to estimating a CMP. The Technical Conference was held on March 2, 2018.

In the Application, the Corporation proposed a Net Capital Maintenance Provision (Net CMP) which is added to the break-even overall rate indication, and consisted of two distinct parts:

- A first component to recognize the expected return on investment assets supporting Basic Total Equity; and

- A second component representing a CMP.

The Corporation's proposed approach to estimating the CMP consisted of determining what magnitude of overall rate level change to take effect on March 1, 2019 was needed in order to maintain Basic's forecasted Minimum Capital Test (MCT) ratio as at February 28, 2019 unchanged over the ensuing twelve months. The Corporation acknowledged that, in some respects, this would represent a shift back from rate-setting in accordance with AAP to again set rates based on expected Basic financial results from the Basic financial forecast, although the Corporation's approach does quantify the rate level contribution of the component parts.

In the course of the Information Request process in this GRA, MPI provided alternative estimates of a CMP based on its understanding of the approach followed by the Saskatchewan Auto Fund. While the Corporation made its best efforts in providing these alternative estimates, these estimates could not be thoroughly tested as evidence, as the Saskatchewan Auto Fund methodology was not a part of the evidentiary record.

3.5. Interveners' Positions

CAC

CAC called two expert witnesses to give evidence on interest rate forecasting and the CMP. Dr. Wayne Simpson is a professor of economics at the University of Manitoba and was qualified as an expert in applied econometrics, applied microeconomics and quantitative methods. Dr. Simpson has testified as an expert in previous hearings before the Board.

Andrea Sherry is Vice-President, Insurance Solutions with the Wawanesa Mutual Insurance Company and was pre-qualified as an expert in actuarial analysis with a focus of pricing, rate-making and risk related to automobile insurers generally including crown owned automobile insurers. Ms. Sherry has been qualified as an expert witness in previous GRA hearings.

While Dr. Simpson and Ms. Sherry were called by CAC to provide evidence in this Application, their evidence is given independent of the positions advanced by CAC, and is intended to assist the Board in making its decision.

With respect to interest rate forecasting, Dr. Simpson and Ms. Sherry co-authored a report entitled *The Role of the DCAT and Interest Rate Forecasting* (DCAT/IRF Report).

The DCAT/IRF Report indicated the authors had two significant concerns with respect to the 2019 GRA:

- A renewed emphasis on attaching the MCT to the determination of the Rate Stabilization Reserve (RSR); and
- The continued use of the Naïve interest rate forecast to determine the break-even rate indication and in the DCAT to determine the RSR target range.

The DCAT/IRF Report acknowledged that the era of low interest rates in the aftermath of the recession of 2008 has been a challenging period for interest rate forecasting. The SIRF had been too optimistic about economic recovery and, until recently, overestimated forecasted interest rates.

However, in Dr. Simpson and Ms. Sherry's opinion, the Corporation's argument for the adoption of a Naïve forecast based upon the ten-year Government of Canada benchmark bond yield should not be accepted.

The DCAT/IRF Report set out that the foundation for rising interest rates remains solid, and that the historical evidence is no longer as important. According to Dr. Simpson and Ms. Sherry, the Naïve forecast used by the Corporation explicitly ignores recent economic information from the Bank of Canada and other sources. Moreover, the report dismissed the Corporation's claim that the Naïve forecast is unbiased. Recent Naïve forecasts have under-predicted interest rate increases and recent economic events, including inflationary pressure, which all point toward higher interest rates as the economy approaches full capacity. Accordingly, this information would imply that there is a much higher probability that the Naïve forecast will under-predict, rather than over-predict, interest rates. In this sense, in their opinion, the Naïve forecast was likely to be more biased in the current economic environment than forecasts of modestly rising interest rates as provided by the SIRF and 50/50 forecasts.

Although the DCAT/IRF report concluded that the 50/50 interest rate forecast should be used for determination of the rate indication and the DCAT analysis, in his testimony in the public hearings, Dr. Simpson testified that the weighting should actually be more in favour of SIRF rather than Naïve and, ultimately, his best estimate was that the SIRF would prove to be most accurate for the 2019/2020 fiscal year.

Dr. Simpson and Ms. Sherry also co-authored a report entitled *The Capital Maintenance Provision Proposal by Manitoba Public Insurance* (CMP Report). Dr. Simpson and Ms. Sherry were of the opinion that a CMP is not necessary. In their view, the procedure that has been adopted in previous GRAs determines the true capital need of the Corporation, based on adverse scenario analysis through a modified DCAT. That analysis determines the amount of capital needed to be held by the Corporation for prudent fiscal management of plausible adverse scenarios and, in turn, determines the RSR range. Since that analysis is carried out yearly, any capital deficiency or surplus could be dealt with through rebuilding fees or rebates on a year to year basis.

In the CMP Report, Dr. Simpson and Ms. Sherry expressed concern that a CMP was not agreed to at the Technical Conference, nor had a CMP been approved by the Board. Dr. Simpson and Ms. Sherry also expressed the concern that the introduction of the CMP is a significant change, given its effect on the requested rate change, and therefore the public should have an opportunity to express its views before such a significant change be implemented.

Further, in Ms. Sherry's view, the CMP would constitute an addition of capital load into the rate indication. The Actuarial Standards of Practice are silent on such an approach and, therefore, in Ms. Sherry's opinion, the CMP would not be "aligned" with AAP. Moreover, the authors noted that the Corporation advised that it is not aware of the existence of any industry, gray or peer-reviewed literature regarding the need or the methodology for establishing a CMP for non-profit, monopoly, public auto insurers.

In addition, because the stated purpose of the CMP is to maintain capital at a steady level based upon a projected MCT ratio, the authors believe the use of an MCT ratio to set a CMP level would be arbitrary. Furthermore, the Board had shown support for the determination of the RSR range based on the DCAT analysis, not an MCT ratio.

Dr. Simpson and Ms. Sherry stated that the introduction and basis for the CMP in the 2019 GRA was incomplete. That is, the Corporation had advised that it is currently developing a capital management plan to more comprehensively deal with the calculation of lower and upper RSR targets, as well as rebuilding fees and rebates.

Finally, Dr. Simpson and Ms. Sherry were of the opinion that the introduction of a CMP would cause intergenerational inequity, by introducing an increase in rates for policy holders in the 2019/20 rating year to the benefit of policy holders in future years.

Accordingly, Dr. Simpson and Ms. Sherry recommended that the proposed CMP not be approved by the Board.

When questioned by the Board concerning the risk that maintaining capital too close to the lower target capital threshold could result in frequent (every four or five years) requests for rebuilding fees, Ms. Sherry expressed the opinion that it would make more sense to keep the rebuilding fee closer to the year in which the capital deficiency was determined. She also expressed preference for the use of rebuilding fees rather than a larger lower target capital threshold as the Corporation's capital position is reviewed annually.

CAC argued that MPI had not discharged its onus to demonstrate that the Naïve forecast should replace the 50/50 forecast for rate-setting purposes, and that a material change in circumstances over the last two years suggests that greater reliance should be placed on the SIRF than the Naïve forecast. CAC also reminded the Board of the evidence of the Corporation’s own expert witness, Dr. Sean Cleary, in the 2017 GRA, recommending use of the 50/50 forecast.

CAC took the position that the CMP should not be approved by the Board and argued that the Board is not obliged to build a cushion for imprudence into the rates, or to pass on imprudent and unreasonable costs on to ratepayers. CAC recommended a rate decrease of -1.75%, the rate resulting from the inclusion of the expected return on the investment assets supporting Basic Total Equity in the rate indication, the rejection of the CMP, and the use of the SIRF or the 50/50 interest rate forecast. CAC also took the position that a further rate reduction could be ordered, based on foregone investment opportunities.

CMMG

CMMG expressed the view that it appears that the intent of the Corporation is to collect as much premium as possible in order to provide "smooth sailing" for the Government and the Corporation, irrespective of the Corporation's mandate.

CMMG also commented that interest rate methodology is extremely important to the motorcycle class as their rate indication is more sensitive to the assumed interest rate than is the case for the other Major Use classes. Considering the upward movement in market interest rates already observed, and the acknowledged Bank of Canada expectation for further increases to come in the overnight rate, CMMG recommended rejection of the Naïve interest rate forecast in favour of the 50/50 forecast.

Using the 50/50 interest rate forecast, excluding the CMP, the breakeven rate indication would be a rate reduction of -0.6% in motorcycle premiums, and should the Board approve the CMP, the rate indication would then only be a 1% increase. While CMMG was not endorsing a rebate, it expressed the view that a rebate would be more appropriate than the Corporation's attempts to collect additional premium. CMMG observed that the increases in the Government of Canada ten-year bond rates and in the Bank of Canada interest rates would not justify the use of the Naïve interest rate formula at this time.

3.6. Board Findings

The Board hereby approves an overall rate increase of 1.8%, based on the Naïve interest rate forecast updated to the end of September 2018, and inclusive of the Corporation’s proposed Net Capital Maintenance Provision, as estimated by the Corporation in MPI Exhibit #26.

In Order 82/18, the Board asked that the Corporation justify the use of the Naïve interest rate forecast and in particular, any change of circumstances since the issuance of Order 130/17 that would warrant the use of the Naïve interest rate forecast. Nevertheless, through the evolution of the Information Request process and in the public hearings, ultimately, significant evidence was devoted to the issue of the interest rate forecast, both from the Corporation and from CAC.

The Board's approval of the use of the Naïve interest rate forecast is for this year only, and applies to rate-setting and the target capital analysis. In the 2020 GRA, the Corporation shall report back on its tracking of interest rate movements and how this informs its decision on interest rate forecasting.

In reaching its decision, the Board recognizes that it has deviated from its position on interest rate forecasting as set out in Order 130/17. However, the Board finds that the Naïve interest rate forecast represents a best estimate for rate-setting purposes, provided that it reflects the evidence led on the latest available market information at the time of the hearing, as was the case in this GRA. The Board has considered all of the evidence with respect to interest rate forecasting in this and previous GRAs, and it bases its decision on the acknowledged and consistently evident uncertainty inherent in forecasting interest rates. The Board acknowledges the comment in the report of Dr. Simpson and Ms. Sherry, that the aftermath of 2008 has been a challenging period for interest rate forecasting. The Board notes that prior to the 2017 GRA, the parties applied the SIRF, notwithstanding eight years of flat interest rates. In the 2017 GRA, when interest rates continued to be flat, MPI's expert witness supported the 50/50 forecast, while CAC's expert supported the SIRF. For this GRA, the parties again changed their positions. The reality is that there is no certainty in predicting interest rates as the correctness of the forecast only becomes obvious in hindsight. The Board finds that building that uncertainty into the rate indication is not reasonable for ratepayers at this time. The Board is prepared to err on the side of caution in determining the best estimate, especially when the Corporation has found it necessary to transfer funds from Extension to fund the Basic RSR in each of the four previous years, which transfers were due, in part, to inaccurate interest rate forecasts.

The Board acknowledges that the Corporation's Asset Liability Management strategy, which is discussed in detail later in this Order, has led to Basic's financial results being considerably less sensitive to interest rate shifts. As a result, any error made with respect to interest rate forecasting will be of much less financial consequence, whether positive or negative, to Basic's operating results and capital position. The Board also notes that, with the adoption of rate-setting in accordance with AAP, interest rate forecasting risk has been reduced by virtue of the shorter forecast horizon required by AAP, relative to that needed previously when setting rates based on forecasted Basic net income. The Board will revisit this issue in less than one year, in the 2020 GRA.

The Board hereby approves the Corporation's proposed Net Capital Maintenance Provision for one year only at this time, accepting the argument in the interim that it is appropriate to provide protection against forecasted natural depletion of Basic's capital position, as measured by the MCT over the coming rating year.

However, the Board's approval of the Net Capital Maintenance Provision is conditional on the Corporation bringing forward, in the 2020 GRA, a capital management plan. The Board therefore directs that in the 2020 GRA, the Corporation bring forward a thorough capital management plan, encompassing the entire Corporation and including the following:

- Minimum, maximum, and/or target capital level for all lines of business;
- A Capital Maintenance Provision built into ratemaking;
- A capital build and release methodology based on the capital targets;
- Clearly defined policy-based constraints on the speed and magnitude of the combined rate impact of rate changes, capital maintenance, capital build, and capital release provisions;
- Clearly defined rules on the transfer of capital from other lines of business; and

- Evolving the basis of estimating Basic's Net Capital Maintenance Provision in a manner consistent with the objective of promoting stability over time in this estimate.

To this end, the Board also directs that a Technical Conference be held, to be facilitated by the Board at a mutually convenient time and in sufficient time to allow any findings from the Technical Conference to be fully reflected in the 2020 GRA, with the objective of developing a stakeholder consensus around a capital management plan, through discussion of the Corporation's draft proposal.

With respect to Ms. Sherry's opinion that the CMP is not "aligned" with AAP, the Board notes that the Actuarial Standards of Practice are silent on this approach, and silence should not be assumed to be non-alignment. Therefore, Board finds there is no evidence to indicate that the use of the CMP would contradict Actuarial Standards of Practice.

The Board acknowledges Ms. Sherry's testimony that RSR rebuilding fees are available if the Corporation falls below the lower target capital threshold, and fee can be introduced when the range is reviewed at the GRA each year. The Board further understands that the Government of Manitoba is always available as a backstop. Notwithstanding, the Board disagrees with the position that it is preferable to contemplate the use of rebuilding fees on a regular basis in the normal operation of the Corporation. Rebuilding fees should be used as an urgent measure when unexpected results are realized. Government interventions should only be required when extraordinary events, beyond the control of the Corporation, occur. Anything less would reflect a fundamental flaw in the Corporation's business model and/or the regulatory system.

Lastly, the Board acknowledges the Corporation's new mission statement, and looks forward to being updated in the 2020 GRA on its progress in implementation of the corporate values in MPI's business model.

4. VEHICLES FOR HIRE (VFH)

By Order 11/18, issued on January 15, 2018, the Board granted to MPI approval of its rates for Vehicles for Hire (VFH), on an interim basis only, recognizing the urgency of the need for rates to be in place, as *The Local Vehicles for Hire Act* was to come into force on February 28, 2018. In Order 11/18, the Board issued a number of directives to MPI, with the expectation that MPI would be in a position to provide further information and experience following the interim approval of the VFH rates in order for MPI to refine its rating model and rates.

MPI sought final approval of the rates approved on an interim basis in this GRA. In the interim Application, which was included in the Corporation's materials filed in this GRA, the Corporation sought interim approval of the following rates for service effective March 1, 2018:

- The premiums charged with respect to compulsory VFH rates for service, effective March 1, 2018.
- Interim VFH rates for service were requested for both the 2017/18 and 2018/19 insurance year, based on rates approved in Board Orders 162/16 and 130/17.
- Changes to eligibility for vehicle premium discounts for VFH.
- Waiving of service fees for change of insurance for VFH.
- A mechanism for refunding/collecting any variance between interim and final approved VFH rates for service, as determined through the 2019 GRA.

The Corporation proposed no changes to miscellaneous permits and certificates, driver license premiums, or fleet rebates and surcharges.

The Corporation stated that, where possible, pricing of its policies was based on known experience, and that pricing of future policies would incorporate claims experience to ensure that customers are paying appropriate premiums. VFH policies would be tracked in a separate pool to ensure there is no impact on other Basic customers.

MPI advised that it evaluated several rating models within the context of the compulsory nature of the Basic insurance program. It reviewed rating models and pricing in Ontario, Alberta and Quebec, and performed an initial scan of rating models used in the United States. According to MPI, no industry standard had yet been developed on insurance rating models across jurisdictions for Transportation Network Companies (TNC). The Corporation had determined that the rating models it reviewed, and which are used in other Canadian jurisdictions, were not suitable to MPI given the compulsory nature of the Basic insurance program.

MPI deemed passenger vehicles and light trucks as eligible for VFH uses in Manitoba.

The Corporation also advised that, to streamline the registration process and system, it would discontinue the registration classes used for existing Taxis, Limousines and Liveries. In the previous scheme, the "X-Plate" registration class was comprised of four classes, and issued licence plates beginning with X: Taxicabs, City Liveries, Limousine Liveries, and Country Liveries. The Corporation advised that the X-Plate registration classes would expire and no longer be issued after April 30, 2018. All VFH vehicles would be issued standard plates.

In the interim Application, MPI proposed four categories for the VFH Rating Model:

- Taxicab VFH
- Limousine VFH
- Accessible VFH
- Passenger VFH

The premiums for each category of VFH were established separately. The insurance premiums would be based on four defined time bands, also referred to as "Levels". Each of the four categories of VFH would have the same four time bands available to them, with customers being able to self-select any combination of the four time bands. Customers would have anywhere from Level 1 coverage to Level 4 coverage, depending on the number of time bands purchased.

Premiums would be based on the number of time bands selected. Upon purchasing four time bands, VFH drivers would have the ability to operate during on selected days and times, up to 24 hours a day, seven days a week. The time bands are as follows:

Time Bands	Time of Insured Commercial Operation
A	Monday through Friday 10:00 am to 3:00 pm and Sunday through Thursday from 7:00 pm to 11:00 pm
B	Nightly 11:00 pm to 7:00 am
C	Monday through Friday 7:00 am to 10:00 am and 3:00 pm to 7:00 pm
D	Friday 6:00 pm through Sunday 11:00 pm

When a VFH is operated outside of its insured VFH time band, it would be insured for non-commercial operation. If a VFH fare originated during an insured time band, but the ride extended beyond the time band and was completed during a non-commercial operation time, the insurance coverage for VFH operation would extend to cover the duration of that fare.

The Corporation also proposed that there be no charge when changing the insurance on a passenger vehicle or light truck to a VFH, although it might re-evaluate this approach in future GRAs.

All VFH would have the following Basic insurance coverage, consistent with Basic's all-purpose Passenger Vehicle Coverage:

- $200,000.00 Third Party Liability
- $50,000.00 Minimum Insured Value
- $500.00 deductible

Therefore, Taxicabs, Limousines and Livery Vehicles would have their Basic deductible reduced by $100.00, from their previous deductible level of $600.00.

In this Application, MPI sought final approval of 2017/2018 and 2018/2019 VFH rates for service, and applied for approval of VFH rates for 2019/2020. The Corporation also reported on certain items about which the Board in Order 11/18 had directed the Corporation to report.

The Corporation advised that the primary means of limiting cross subsidization between VFH and the rest of Basic was through the creation of a new pool to track the VFH claims experience. It reported that it is collecting the same information on VFH policy claims as it does for all other policies, and claims experience for VFH classes will be tracked separately, which will form the VFH pool used to set actuarially sound rates for VFH policies. In addition to establishing a separate pool, MPI will continue to employ its processes to ensure that claimants are correctly insured at the time of a claim.

MPI reported that it had conducted an ongoing review of rating models used in other Canadian jurisdictions. Those other models were not considered suitable with Manitoba's public insurance environment given the compulsory nature of Basic. At the time of the Application, neither British Columbia nor Saskatchewan had permitted the operation of TNCs; accordingly, MPI's review of other jurisdictions could not include comparable public insurers.

MPI had assumed that the Taxi class of VFH would experience a $1 million reduction in premiums, relative to a written premium base of $5.7 million, reflecting an approximately 17.5% reduction in premium. To date, the Corporation reported, the average Taxi VFH has received a DSR discount of approximately 20.6%, and the claims costs for Taxi VFH have tracked closely with the premium reductions.

As of April 30, 2018, MPI reported a total of 872 vehicles insured as VFH, with the vast majority being comprised of the Taxi (497 vehicles insured) and Passenger (304 vehicles insured) classes. As of May 22, 2018, there were a total of 191 VFH-related claims.

4.1. *Board Findings*

The Board hereby grants final approval of the rates applied for by the Corporation in its Vehicles For Hire Rate Application, filed with the Board on December 15, 2017, and approved on an interim basis by the Board in Order 11/18. The Board recognizes that TNCs are a relatively new phenomenon in Manitoba and as such it will take time for claims experience to be gathered and tracked for the VFH pool. The Board directs that in the 2020 GRA, the Corporation file information as to its claims experience to date for the VFH class.

5. DRIVER SAFETY RATING (DSR)

As set out above, in the 2018 GRA, the Corporation applied for an increase to the demerit premiums for the DSR system. The Board approved the Corporation's application in that regard, but required that the Corporation undertake further work such that in the future, DSR rates and vehicle premium discounts would be based on principal driver rating than the registered driver rating. To that end, the Board directed in Order 130/17 that a Technical Conference take place on the availability and practicality of other analytical tools and ratemaking methodologies to better determine DSR rates and vehicle premium discounts based on principal driver rating rather than registered driver rating. The Board also directed the Corporation to file proposed driver premium rates more statistically consistent with the estimated average claims cost per driver for each level on the demerit side of the DSR scale in this Application, and, in the 2021 GRA, file proposed vehicle premium discounts that are actuarially indicated based on principal driver performance evaluation.

The Corporation applied for a review and variance of those aspects of Order 130/17, on the basis that the foundational structure and purpose of the DSR program and the vehicle premium discounts were only given a cursory review in the 2018 GRA, and there was insufficient evidence or consideration given to justify changes to the structure and implementation of the DSR program. MPI took the position that while it might be appropriate to change the framework for the DSR scale, this should only be done after consideration is given to a complete evidentiary record.

By Order 29/18, the Board granted MPI's application in part. First, with respect to the requirement for a Technical Conference, the Board directed that it be undertaken in order to review the availability and practicality of other analytical tools and ratemaking methodologies to better determine DSR rates and vehicle premium discounts based on principal driver rating rather than simply registered driver rating. The information shared in the Technical Conference was to be included in this Application. Further, in this Application, MPI was required to file information as to how it would proceed to implement driver premiums more statistically consistent with the average claims cost per driver for each level on the demerit side of the DSR scale, and vehicle premium discounts fully supported by actuarial indications based on principal driver performance evaluation. If MPI's position was that it is not possible to implement driver premiums more statistically consistent with the average claims cost per driver for each level on the demerit side of the DSR scale and/or vehicle premium discounts that are fully supported by actuarial indications based on principal driver performance evaluation, MPI was to advise the Board in this Application, and file information as to why that is the case.

The Board also varied those aspects of Order 130/17 that required the Corporation to file proposed driver premium rates more statistically consistent with the estimated average claims cost per driver for each level on the demerit side of the DSR scale in this Application, and, in the 2021 GRA, file proposed vehicle premium discounts that are actuarially indicated based on principal driver performance evaluation. In Order 29/18 the Board varied those directives such that they were to be held in abeyance until such time as the issues of driver premiums more statistically consistent with the average claims cost per driver for each level on the demerit side of the DSR scale, and vehicle premium discounts that are fully supported by actuarial indications based on principal driver performance evaluation, were reviewed and considered in the this Application.

The Technical Conference on the DSR took place on March 20, 2018.

In this Application, the Corporation stated that DSR-based driver premiums should be actuarially sound, and that it is considering options for alternative models. This includes engagement with the public, as well as gathering of data. MPI advised that it plans to provide an update on or the results of its analysis in the 2020 GRA. MPI did acknowledge that it needs to improve the actuarial soundness of the DSR-based driver premiums and vehicle premium discount calculations, which are currently set by policy.

The Corporation also stated that it can improve the DSR model, to ensure that risk is better reflected in driver premiums and vehicle premium discounts under the DSR scale. These improvements will result in further disincentives for engaging in high-risk driving behavior and customers at the top and bottom of the DSR scale will pay rates that better align to their driving behavior. MPI has not yet determined that DSR ratemaking methodology should be based on principal driver performance evaluation.

The Corporation reported on certain models for driver premiums and vehicle premium discounts that might be considered in determining what changes should be made to the DSR rating system, and provided its views on each of the models. The models reviewed include: Primary Driver, Declared Driver, Forced Assignment, and Residual Risk.

Primary Driver would require policyholders to identify the primary driver of the each vehicle in the household. The Declared Driver model would require the policyholders to identify the regular drivers of the vehicle, and the Corporation could determine vehicle discounts based on some variable (i.e., average, lowest DSR rating) of the listed drivers of the vehicle. Forced Assignment would require MPI to develop the ability to easily and accurately identify all licensed drivers in a given household, and then determine vehicle discounts on the basis of the DSR data gathered about those drivers, or to assign specific vehicles to certain drivers for rating purposes. The Residual Risk model would ensure that drivers who do not register vehicles pay an actuarially determined driver premium based on their historic risk, and driver premium collected from non-owners would be used to lower vehicle premiums, and/or improve the actuarial soundness of the vehicle premium discounts.

The Corporation is in the process of researching these models. With respect to the demerit side of the DSR scale, the Corporation noted that is where drivers create risk; accordingly, it needs to collect more premiums from that particular group, but the current model that is used is not actuarially sound.

The Corporation reported that the next steps towards the implementation of more actuarially sound DSR premiums and vehicle premium discounts will involve its public consultation efforts, along with further investigation and analysis of those rating models having limited or no additional IT costs (Primary Driver and Residual Risk). It reported that it anticipates by the 2020 GRA, it will be in a position to report on the results of its public consultation efforts, its preliminary research on the no or low cost options, and whether it intends to proceed with data collection for higher cost options (Declared Driver and Forced Assignment).

5.1. Interveners' Positions

CAC

While CAC did not advocate for a particular rating model, it did express the view that, given the potential dramatic changes to DSR which could result from the Residual Risk approach, MPI should be directed to engage with stakeholders, including CAC, CMMG, CAA and Bike Winnipeg, regarding best practices for consumer engagement and recommendations on DSR.

5.2. Board Findings

The Board recognizes that MPI is continuing to do work necessary in order to assess, and ultimately implement, a DSR system that is more actuarially sound. Accordingly, the Board directs that in the 2020 GRA, the Corporation report on the progress of its public consultation efforts, its preliminary research on the no or low cost options for rating models, as well as on its decision on whether to proceed with data collection for the higher cost options.

As to the recommendation made by CAC, the Board is not prepared to direct the Corporation as to the manner in which the Corporation is to conduct its public consultation on the DSR. The Board anticipates that in the 2020 GRA, the Corporation will provide a full report as to its engagement with the public, which can be fully assessed and considered in the course of the 2020 GRA.

6. PROGRAM COSTS

The costs associated with providing Basic Insurance to Manitoba motorists fall into the following major categories:

	Total Estimated Expense 2019/20 ($ millions)	Percentage of Total Program Costs
Net Claims Incurred	**$900.2**	**74.8%**
Claims Expenses	**135.4**	**11.3**
Road Safety/Loss Prevention	**12.7**	**1.1**
Operating Expenses	**73.6**	**6.1**
Commissions	**42.7**	**3.5**
Premium Taxes	**33.7**	**2.8**
Regulatory/Appeal expenses [1]	**4.8**	**0.4**
Total Program Costs	**$1,203.1**	**100.0%**

6.1. Basic Claims Incurred

Claims Incurred represent the costs that are paid or forecast to be paid to claimants for the various benefits provided under the Basic Insurance program. Net Claims Incurred were $767.2 million in 2017/18, which was $27.8 million or 3.76% over the budget presented at last year's GRA.

[1] Regulatory and appeal expenses relate to: Public Utilities Board, Crown Corporations Council and Automobile Injury Claims Appeal Commission.

The 2019/20 Net Claims Incurred Forecast decreased by $12.6 million from the forecast presented in the 2018 GRA, primarily as a result of the following:

- A decrease of $18.9 million due to a lower forecast for Physical Damage claims;
- A decrease of $7.9 million from a lower forecasted Write Down DPAC/Premium Deficiency; and
- An offsetting increase of $13.2 million from a forecasted decrease in claims discount rate and higher forecasted Unallocated Loss Adjustment Expense.

Claims Incurred for the fiscal years 2014 - 2018 for the major coverages were as follows:

For years ending February 28/29 ($ millions)	2014	2015	2016	2017	2018	5 Year Change	
Physical Damage - All Perils							
Collision	374	315	354	409	426	52	14%
Comprehensive	77	70	123	118	67	(10)	(13%)
Property damage	48	38	41	43	49	1	2%
Sub-total	**499**	**423**	**518**	**570**	**542**	**43**	**9%**
PIPP Accident Benefits	245	317	142	284	220	(25)	(10%)
Public Liability	3	6	6	5	5	2	67%
Total Claims Incurred	**747**	**746**	**666**	**860**	**767**	**20**	**3%**

Overall Total Claims Incurred were $767.2 million in 2017/18, and are forecast to be $817.1 million in 2018/19, $900.2 million in 2019/20, and $950.7 million in 2020/21, for an overall increase of $183.5 million or almost 24% from 2017/18.

A major component of Total Claims Incurred are collision claims costs, which were $426.5 million in 2017/18. The Corporation indicated that, relative to the long-term average, the last four accident years have had below average collision frequency. Some of the reduction in frequency can be attributed to mild winters although there has also been a reduction in summer collision frequency over the last six years.

The Corporation also advised that collision total loss frequency has been increasing over the past decade. As vehicles become increasingly complex and more expensive to repair, there has been an increase in the percentage of collision claims resulting in total losses. The largest component of Total Claims Incurred is Accident Benefits, which are payable to claimants regardless of fault for a collision, including medical expenses, rehabilitation expenses, funeral expense reimbursement, death payments, impairment benefits, income replacement indemnity and personal care assistance. The estimated cost of Accident Benefits under the Personal Injury Protection Plan (PIPP) program are updated based upon actuarial reserving practices taking into account changes in interest rates on long term claims liabilities.

The following table compares actual PIPP Accident Benefit costs with those previously forecast by the Corporation:

Year Ended February 28/29	**Original Forecast**	**Revised Forecast**	**Actual Cost**	**Difference Original/ Actual *Favourable (Unfavourable)***
2009	$242.1	$239.3	$186.1	$56.0
2010	$249.8	$236.2	$175.0	$74.8
2011	$252.9	$244.6	($59.7)	($312.6)
2012	$253.3	$197.3	$222.8	($30.5)
2013	$203.5	$204.2	$224.2	($20.7)
2014	$210.9	$208.5	$243.9	($33.0)
2015	$184.4	$148.9	$314.5	($130.1)
2016	$166.1	$90.6	$143.0	$23.1
2017	$148.7	$117.9	$283.9	($135.2)
2018	$150.4	$242.6	$281.9	($68.5)

Current fiscal period Claims Incurred are affected by the current year's claims activity, as well as prior years' claims activity. When a claim is first incurred, claims adjusters estimate the ultimate cost of that claim. Over time, as more is learned about the nature of the underlying injury and as partial claim payments are made, adjustments are made to the prior estimate of the ultimate cost of the claim. These adjustments, sometimes called “runoff”, flow through Claims Incurred in the fiscal year in which the adjustments are made.

6.2. Basic Expenses Overview

Operating expenses incurred by the Corporation are allocated to Basic pursuant to a cost allocation methodology approved by the Board in Order 157/12. The cost allocation methodology distributes Corporate expenses to four lines of business, and then further segregates them into four expense categories: Claims, Road Safety/Loss Prevention, Operating and Regulatory/Appeal.

The details of Basic Operating expenses are as follows:

	For the Years Ended February 28/29 ($ millions)				
	2018A	**2019B**	**2020P**	**2021P**	**2022P**
Total Corporate Expenses	**$299.2**	**$301.7**	**$298.8**	**$306.7**	**$319.0**
Basic Allocated Corporate Expenses					
Claims Expense	143.3	137.2	135.4	139.2	144.3
Road Safety/Loss Prevention	13.2	13.6	12.7	12.8	13.0
Operating	70.2	75.1	73.6	76.3	80.0
Regulatory/Appeal	4.4	4.7	4.8	5.0	5.1
Total Basic Allocated Corporate Expenses	**$231.1**	**$230.6**	**$226.5**	**$233.3**	**$242.4**
Percentage of Corporate Operating Expenses	77.3%	76.4%	75.8%	76.1%	76.0%
** A = Actual B = Budget P = Projected					

6.3. Claims Expenses

Claims expenses represent the administrative costs associated with processing and settling claims. Claims expenses were $120.9 million in 2016/17, $143.3 million in 2017/18, budgeted to be $137.2 million in 2018/19, and are projected to be $135.2 million in 2019/20.

6.4. *Operating Expenses*

The Corporation reported that it has been diligent in controlling and reducing expenses, stating that it had taken the following steps to contain costs:

- An expected reduction in Full Time Equivalent (FTE) staffing counts equating to 3.6% from 2020/21 as compared to the 2017/18 budgeted levels;
- An overall reduction in 2017/18 normal operating expenses of approximately 1% as compared to 2016/17;
- Achievement of a 2017/18 management-controlled reduction of more than $2.6 million;
- A 2018/19 budget which includes the achievement of the 15% management reductions from 2016/17, and committed staff reductions through improvement initiative efficiencies;
- A reduction in implementation expenses in the rating years and throughout the forecast, mainly due to an enhanced focus on Value Management related to projects and a zero budget for insertions of work; and
- Continued reduction of building expenses via identification of efficiencies/synergies, which has led to further building closures.

Operating expenses allocated to Basic were $231.1 million in 2017/18, budgeted at $230.5 million in 2018/19, and projected to be $226.6 million in 2019/20 and $233.3 million in 2020/21, equivalent to compounded annual growth of 0.3% over the three-year forecast period.

MPI reported that it continues to prioritize and control day-to-day operational expenses and project expenses. MPI is committed to providing value to Manitobans through cost containment, which has become firmly embedded into MPI’s culture. For the years 2018/19 and outward, forecasted expenses overall are lower, most notably in the 2019 GRA rating years (2019/20 and 2020/21).

Compensation expenses (salary and benefits) represent 58% of MPI's total operating costs. The Corporation incurred $172.6 million in compensation expenses in 2017/18, and budgeted for compensation to grow to $176.4 million in 2018/19, $181.8 million in 2019/20, and $186.5 million in 2020/21. The Corporation adjusts the gross salary budget by a vacancy allowance, on an overall basis, to reflect what it anticipates will be the actual salary expenditures in a given year. The Corporation has stated that, at any given time, there are vacant positions within its staff complement, referred to as a vacancy provision, which reduce salary expenses. The Corporation incurred a vacancy allowance of $7.1 million in 2017/18 and budgeted for a vacancy allowance of $1.5 million for years 2018/19 through to 2020/21.

MPI incurred net compensation costs of $165.6 million in 2017/18, and has forecasted net compensation costs of $174.9 million in 2018/19, $180.0 million in 2019/20, and $183.9 million in 2020/21.

Basic is allocated all operating expenses, including compensation costs, through the Corporation's integrated cost allocation methodology. Basic is allocated approximately 76% of Corporate compensation expenses. In the case of both the allocation of operating expenses and compensation expenses, the Board is unable to consider the appropriateness of the allocations as it lacks the jurisdiction over the Extension line of business. The allocation of compensation expenses to Basic has increased from $116.0 million in 2014/15 to $124.4 million in 2017/18, a compounded annual growth rate of 2.4% over the four-year period. Basic compensation expenses are forecast to be $130.5 million in 2018/19, and projected to be $133.7 million in 2019/20 and $138.0 million in 2020/21. This represents a compound growth rate of 3.2% over the forecast period.

The five-year Collective Agreement between MPI and the Manitoba Government and

General Employees' Union is in effect for the period from September 18, 2016 to September 26, 2020 and includes general economic increases of 1.50% effective September 17, 2017 and 2.00% effective September 16, 2018. The agreement will see a further 2.00% increase in 2019 and a 0.0% increase for the final two years of the agreement.

In addition to the economic increase, the Collective Agreement also specifies a pay plan with six "step" salary ranges for each in-scope position in the Corporation. An employee will be eligible for up to five annual 3.5% increases until the employee reaches the maximum salary (step) for the position. Upon reaching the maximum salary, the employee will only be eligible to receive general economic wage increases. MPI estimates that 50% of its employees are eligible for these annual "step" increases, which is the equivalent of an overall additional 1.75% salary cost increase. MPI is forecasting an annual increase in salary costs of 4.9% for 2018/19.

MPI's total Corporate staff complement has decreased from 1,946.8 FTEs in 2009/10 to 1,878.1 in 2017/18, and is forecast to grow to 1,902.5 FTEs in 2018/19. The composition of MPI's staffing dedicated to operations and improvement initiatives is as follows:

Year	Normal Operations	Special Initiatives	Total Corporate
2009/10	1,752.9	193.9	1,946.8
2010/11	1,822.8	48.6	1,871.4
2011/12	1,862.9	15.4	1,878.3
2012/13	1,894.7	17.1	1,911.8
2013/14	1,890.3	15.0	1,905.3
2014/15	1,874.8	10.7	1,885.4
2015/16	1,866.7	15.7	1,882.4
2016/17	1,898.9	21.2	1,920.1
2017/18 Actual	1,860.9	17.3	1,878.1
2018/19 Budget	1,874.1	28.4	1,902.5

MPI’s Normal Operations staffing levels increased from 1,752.9 FTEs in 2009/10 to 1,860.9 in 2017/18. MPI committed to a permanent staffing reduction associated to improvement initiative efficiencies. Taking into account targeted staff reductions, the Corporation is budgeting for 1,874.1 FTEs in 2018/19 and 1,877.1 FTEs in 2019/20 and 1,859.1 FTEs each subsequent year through 2022/23.

MPI's actual Normal Operations staffing levels have been consistently below budgets as follows:

Fiscal Year	Actual	Budget	Over/(Under) Variance
2008/09	1,732.9	1,796.3	(63.4)
2009/10	1,752.9	1,783.8	(30.9)
2010/11	1,822.8	1,850.1	(27.3)
2011/12	1,862.9	1,926.5	(63.6)
2012/13	1,894.7	1,936.7	(42.0)
2013/14	1,890.3	1,934.7	(44.4)
2014/15	1,874.8	1,927.7	(52.9)
2015/16	1,866.7	1,898.7	(32.0)
2016/17	1,898.9	1,927.5	(28.6)
2017/18	1,860.9	1,910.0	(49.1)
2018/19 Budget		1,874.1	

The consistent under budget variance is a reflection of the Corporation's Vacancy Management Program, which as discussed above, is used as a means to control costs and to ensure proper workforce composition to meet operational demands.

6.5. Information Technology Expenses

The Corporation spent $85.1 million in total Information Technology (IT) expenses in 2017/18, has budgeted to spend $76.2 million in 2018/19, and is forecasting to spend $70.8 million in 2019/20.

The majority of the capital expenditures in IT relate to ongoing and future IT projects, including Legacy Systems Modernization, which relates to the replacement of dated legacy systems, Autopac On-line, Claims Administration and Reporting System, and the Driver Licensing System. These systems support both the Basic competitive lines of business at a budgeted cost of $58.6 million.

Through the Corporation's Value Management Process, it has created business cases for Business Transformation Office-managed projects of $500,000 or more in the 2018/19 Capital Budget. Those budget items are as follows:

- Technology Risk Management: $4.5 million

- Legacy Systems Modernization: $2 million

- High School Driver Education Phase 3: $1.9 million

- Customer Self-Service Phase 1: $1.5 million

- BI[3] / Fineos Upgrade: $1.26 million

- Credit Card Strategy: $ 1 million

- Finance Re-Engineering: $500,000

In the 2018 GRA, the Corporation reported that it was expecting strategic direction from its Board of Directors in December of 2017, after which it would in a position to implement a new IT strategic plan. The Corporation filed the 2018/19 IT Strategy in this GRA, and reported that it focuses less on specific projects and more on bridging strategy and action. The Corporation also reported that the IT Strategy will be updated annually. MPI indicated that significant changes and practices have been adopted through the new IT Strategy. In particular, six main streams were discussed that were changed from the prior technology approach, which are to:

- Move toward proven technologies;

- Identify all risks of a project prior to project initiation;

- Use a Project Sponsor;

- Align when possible to industry best practices in vendor provided software;

- Engrain the Value Management process in MPI culture and the project lifecycle; and

- Create IT capabilities to support business capabilities, in order to solve a business objective.

With respect the Corporation's IT approach in the past, it conceded that certain attempts to be an innovator were not successful, including the Customer Claims Reporting System (CCRS), which was cancelled in April 2018 - although the Corporation retains intellectual property upon which it can rely in the future. As well, the Physical Damage Re-Engineering (PDR) Program, which is discussed in detail below, was a large, multi-year project for which the Corporation acknowledged it failed to adequately project costs, instead focussing on benefits. The Corporation maintained, however, that the PDR program has standardized and improved estimating process and opened up future possibilities for the Corporation.

In addition, with respect to the Corporation's Value Management Process, it also conceded that it was not consistently applied to projects, resulting in projects moving forward without having been evaluated through the Value Management Process.

MPI described the significant changes it has made in how projects are managed and approved, including process changes, and the addition of an Operational Business Champion (OBC), who will now be accountable for the project success, with outcomes stated in the business case for a given project under the purview of the OBC. Each IT project will now contain multiple phases, with identifiable checkpoints, where there is an expected level of completion with respect to certain deliverables and key aspects of the project to be completed.

The Value Management office will validate a business case, and will review it from a quality assurance perspective. The Value Management office will work with the OBC, to determine whether the project is still on track. For any given project, the Executive Steering Committee is responsible for the approval of submissions made to the Board of Directors. Weekly status reports are to be provided to the Executive sponsors of a project and monthly status reports are to be provided to the Executive Steering Committee, along with quarterly status reports to be provided to the Board of Directors.

Prior to 2018, major IT capital projects did not have complete business cases. The Corporation has implemented a new Value Management Process, pursuant to which, all IT projects of $500,000 will require business cases. The Corporation has reported that, if a project does not have a positive return on investment, there will need to be a strong justification to proceed with the expenditure.

With respect to the Corporation's present IT approach, the Corporation maintained that the use of the IT Strategy and the Value Management Process will ensure best practice is followed and will ensure that new IT projects are properly costed. Applying Value Management to CCRS and PDR resulted in a change of direction with respect to those projects, demonstrating the potential of the Value Management Process. To date, MPI's IT staffing strategy has resulted in 20 of 27 external IT consultants being transitioned to employees and, the Corporation reported, it continues to make progress towards its goal of IT staff internalization.

With respect to the future for MPI's IT, one of the primary focuses will be on Legacy Modernization. The Corporation's Planning and Technology Committee intends to authorize management, following negotiations, to engage a consultant with the purpose of undertaking a Legacy Modernization assessment, in order to determine how best to proceed related to the replacement of the legacy computer systems. The Corporation has established a budget of $2 million to do exploratory work on options to address the replacement of the Legacy Systems, and a preliminary budget of $70 million for the Legacy Modernization project. It is anticipated a detailed business case will be created and provided to the MPI Board. Currently, MPI is forecasting to spend $8.1 million on Legacy Systems Modernization in 2019/20, and $16.3 million in 2020/21. It is anticipated that this will be the Corporation's largest IT initiative.

A significant portion of this Application involved a review of the PDR program. As reported in Order 130/17, the program has been in progress since 2010/11. The Corporation reported in the 2018 GRA that it was scheduled for completion in 2019/20, and, in the 2018 GRA filed an evaluation of the PDR project prepared by Gartner Consulting, the Physical Damage Re-Engineering (PDR) Program Evaluation (2017 Gartner Report). The Corporation had also previously filed an evaluation of the PDR program, prepared by Gartner, in the 2017 GRA.

The 2017 Gartner Report found that in the previous year the program had "made significant strides in completing some projects, and reevaluating and cancelling others that would provide low value." It also found that a number of significant components had been put into place over the previous year. At that time, there were five IT projects required to complete the PDR project, with four scheduled to be completed in 2017/18 and the fifth and final project, CCRS, to be completed in 2019/20. The original PDR program contained 20 projects, seven of which Gartner found had been cancelled. Eight of the IT projects contained within the PDR program were completed.

The 2017 Gartner Report found that the overall program budget had been consistent at \$65.5 million, with \$43.4 million spent to date and \$18.1 million remaining to complete the program. The total projected spending would be \$61.5 million, or \$4 million less than the approved budget amount. According to that report, the program was expected to generate an internal rate of return of 7%, with a Net Present Value (NPV) of \$13.7 million over the period from inception until ten years after full implementation when benefits start to accrue. The Gartner Report found that the PDR program was starting to produce measurable benefits.

As also reported in Order 130/17, in the 2017 GRA, Gartner had assessed that the PDR program had a NPV benefit overall of \$18 million, with an internal rate of return of 8%. Gartner prepared the NPV analysis for the 2017 GRA, when MPI was not using NPV as a project management tool. The cost/benefit analysis conducted by Gartner for the 2017 GRA did not include the cost of maintaining the program. The evidence in the 2018 GRA was that the calculation of the NPV of $13.7 million was conducted by MPI, and provided to Gartner.

In Order 130/17, the Board directed the Corporation to have Gartner prepare an update of the PDR program, along with a breakdown by the Corporation of its analysis on the costs to operate and maintain the program, and a cost/benefit analysis of the five remaining projects to be completed as part of the PDR program, with the discount rate used in the cost/benefit analysis to be higher than the 3% previously used in the PDR project cost benefit evaluation.

In this Application, the Corporation reported that management undertook a review of the PDR program in early 2018, applying the Value Management Process, resulting in a restatement of the PDR costs and benefit projections. The total budget of the PDR program was changed to $57 million, from the originally projected $65 million, based on the reduction in scope of the project.

Further, the updated analysis prepared by Gartner, the *Physical Damage Re-Engineering (PDR) Program Evaluation* (2018 Gartner Report), revised the capital costs to $57 million from the previous estimate and drastically reduced the NPV of the project from $13.7 million previously reported to a NPV of ($49.9) million. The Corporation made the decision to cancel the CCRS project, finding that the benefits of the project would not be supported by the costs to achieve them. There remained some smaller projects within the overall PDR program, all of which were forecast to be completed within fiscal year 2018/19. Gartner, based on its evaluation of the program, was supportive of the decision to complete those remaining projects.

The 2018 Gartner Report provided an explanation for the significant variance in the NPV of the PDR program:

- Some costs that should have been attributed to the program were not included in the analysis (for example, the Mitchell licence fee, and an $81 premium paid to repair shops for each claim processed);

- Some of the benefits related to the program are not achievable without CCRS, which was cancelled; accordingly, the annual benefits were reduced to under $8 million from the previous $13 million; and

- Higher discount rates were used for the cost of capital - 6.5% and 9.5% - as compared to the 3% previously used by Gartner.

In addition to the foregoing, as part of its overall Value Management Process review, MPI wrote off $20.5 million in deferred development projects, of which $18.5 million related to Basic projects. MPI-reported a write-off of $15.6 million in deferred project costs associated with the cancellation of CCRS.

Charles E. (Chuck) Henry, Vice President, Solutions and Pricing with Gartner, testified as an expert witness in the public hearings. He was qualified by the Board in Order 82/18 as an expert in the area of the use and planning of information technology, and information technology governance. Mr. Henry was the author of the 2018 Gartner Report and provided testimony on the report. The 2018 Gartner Report indicated that the decision to cancel the CCRS included the cancellation of Optimized Adjusting, co-development of the Mitchell solution, building out the Claims Administration Reporting Solution, managing the change management for the delivered solutions, and building out the analytics tools to monitor and manage the new service delivery channel. The total write off related to these projects amounted to $16.08 million.

Mr. Henry testified that the significant difference noted in some of the costs and the benefits and the overall net present value between the 2017 Gartner Report and the 2018 Gartner Report was due to both understating the costs and overstating the benefits of the program. Gartner was not aware of some of the ongoing operating costs, as they had not been provided to Gartner by MPI. Mr. Henry's evidence was that it would have been the responsibility of MPI to provide Gartner with all relevant information. With respect to the cost of capital, MPI was not using NPV as a project management tool. Gartner had selected a discount rate of 3% and, as MPI was not using NPV, Gartner did not have a rate available to it.

Neither the Corporation nor Gartner had included the cost of operating and maintaining the PDR program in the analyses filed with the Board previously. Mr. Henry's evidence was that Gartner had asked multiple times for that information, but MPI did not make it available, so Gartner proceeded with the high-level information available to it. Mr. Henry acknowledged that Gartner's independent analysis last year did not reflect the more rigorous approach utilized by MPI management this year, and represented a more high-level estimate. Mr. Henry conceded that Gartner should have qualified in prior reports that, while the high-level numbers showed a $13.7 million NPV, further analysis was required. If Gartner had been aware of the operating costs, the report would have been firmer that more analysis needed to be done on the data to make sure that the project continued to make sense.

MPI utilizes both internal FTEs and external consultants to maintain MPI's IT systems and deliver on IT capital projects. MPI's IT actual and forecast staffing levels including consultants are as follows:

IT Staff Complement

	Actual					Forecast		
Year Ended February 28/29	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
Internal FTE	212	210	223	236*	272*	286*	290*	290*
Consultants	120	110	114	107	107	82	80	80
Total	332	320	337	343	379	368	370	370
% IT Consultants	36%	34%	34%	31%	28%	22%	22%	22%

* rounded.

In Board Order 128/15, the Board directed MPI to assess opportunities for savings relative to external IT consultants, including bringing consultants in-house. In response, MPI undertook a comprehensive review and developed an approach to transition up to 27 positions from external to internal over the 2016/17 to 2019/20 fiscal years. MPI provided an update on this strategy, reporting that:

- To date, 20 positions have been successfully converted from external to internal;
- Cost savings are in line with amounts that were previously estimated;
- Potential positions to be converted continue to be assessed, and the Corporation remains committed to converting the remaining seven positions by 2019/20;
- Once the external labour strategy has been fully executed, the annual cost savings are expected to be between $2.4 and $3.0 million;

- MPI continues to explore opportunities to reduce the volume of and costs related to the use of external labour and anticipates additional measures in place in Q4 2018/19; and
- An update on the results of the external labour strategy and the additional measures taken in 2018/19 will be included in the 2020 GRA.

MPI reported that most of its project managers are consultants rather than employees. MPI is attempting to shift the split from being mostly consultants, to more MPI employees. One challenge to this approach is that MPI's contracts contain non-solicitation clauses, so the Corporation cannot approach consultants working under contract with it to attempt to hire them to work internally.

6.6. Benchmarking

The Corporation again filed with the Board its benchmarking framework, reflecting four subject areas: Operational Efficiency, IT Service Delivery, Serving Manitobans and Community Impact. MPI uses the benchmarking results to identify opportunities to reduce costs, measure effective management approaches, and measure efficient resource allocation.

MPI engaged the Ward Group, as it has done previously, to provide an independent perspective on how the Corporation compares to other companies and monitor performance. The Ward benchmarking process involves on-site best practice analyses at MPI, and on-site meetings with MPI management to review customized results developed for MPI. The Corporation advised that after the second year of collecting information, a trend analysis report is prepared annually to assist MPI management in monitoring year-to-year performance improvement. Ward compared MPI to three benchmark groups:

- 10 Canadian insurers for the Canadian Personal Auto Benchmark Group;
- 10 Canadian insurers for the Canadian Benchmark Group; and

- 7 US insurers for the US Personal Auto Benchmark Group.

The Ward Group's 2016/17 comparison showed that the Corporation performs well against the benchmark groups in many of the Operational Efficiency measures. The Corporation's total gross expenses, both as a percentage of gross premiums written and per policy in force, are below the comparators including the three benchmark groups list. MPI's performance on FTEs per $100 million of Gross Premiums Written (GPW) has improved since 2012/13 moving from 153.25 in 2012/13 to 128.30 in 2016/17; however, it remains materially higher than its peers, which range from 102.78 to 107.79. The Corporation explained that this is due to its business model, where customer service is performed end-to-end by MPI employees. MPI therefore provides more comprehensive customer service than its peers, but this results in more staff.

MPI reported that its staff to management ratio increased from 6.83 in 2012/13 to 7.52 in 2013/14, and then decreased to 7.04 in 2014/15 and to 6.64 in 2015/16. It has since increased to 6.95 in 2016/17, due to a decrease in management. Based on the Ward analysis, MPI's staff to management ratios are higher than the Canadian and US benchmark groups, and the Corporation's overall personnel expenses per FTE and Management personnel expense per FTE are lower than those of the benchmark groups.

In prior GRAs, the Corporation has filed the Gartner CIO Scorecard, which provides a comparison of certain of the Corporation's IT benchmarks to those of its peers. In this Application, the Corporation filed information from Gartner which included the CIO Scorecard as well as Gartner's IT Score, the latter of which will be used for future IT benchmarking purposes. The CIO Scorecard has been discontinued and will no longer be used.

The Corporation reported that overall, Gartner benchmarking results indicate that MPI continues to improve its IT Maturity and IT spending relative to operating expenses, which have continued to decrease annually. The Corporation advised that, with its planned reduction in the current project portfolio, it is expected that going forward, personnel spending will also decrease, particularly with respect to consultants. MPI also reported that its IT Strategy has evolved from an earlier state to reflect improved maturity in key areas of Enterprise Architecture, Information Security and Value Management.

Specifically, Gartner's CIO Scorecard indicated that MPI spends 62% of its IT budget on personnel, compared to its peers, at 45%. Contractors comprise 32% of MPI's IT staff, compared to 24% for its peers. MPI improved its overall IT Maturity rating from 3.42 in 2015/16 to 3.52 in 2016/17.

The IT Score employs a different methodology than the CIO Scorecard, with additional elements and weightings that vary based on the capability being assessed. All capabilities are rated on a five-point scale with higher scores indicating better performance. In 2016/17, MPI's overall IT Maturity level was assessed at 3.1 using the IT Score methodology. Overall, MPI scored above the insurance average in all but two capabilities: MPI was on par with the insurance average in Applications Organization with a score of 2.4; and its Enterprise Architecture score was lower than insurance average at 2.3, compared to 3.0 for its peers.

Historically, the Corporation has filed information as to recommendations made by Gartner for MPI to improve its process maturity, and MPI's progress on those recommendations. With the transition from the CIO Scorecard to the IT Score, Gartner conducted a review of all outstanding recommendations provided using the CIO Dashboard tool and updated the recommendations as applicable. This resulted in some recommendations being withdrawn, and some new recommendations being introduced.

In Order 128/15, the Board directed MPI to seek to gain insight on longer tail experience from outside the Province of Manitoba, and in particular, from the Société de l'assurance automobile du Québec (SAAQ). In the 2017 GRA, the Corporation advised that it did not undertake the review as directed, and indicated that it would conduct a review of mortality assumptions in the next year. As a result, in Order 162/16 the Board again directed the Corporation seek to gain insight on longer tail experience from SAAQ, and report back on the results of its efforts in the 2018 GRA. The Corporation did not comply with this directive in the 2018 GRA. Accordingly, in Order 130/17, the Board directed the Corporation to report back on its efforts to seek insight on longer tail experience from other jurisdictions, and in particular from the SAAQ.

In this Application, the Corporation provided the information as directed by the Board. MPI reported that it contacted both Saskatchewan Government Insurance (SGI) and SAAQ, and requested their paid loss experience for Income Replacement benefits for the history of their public insurance programs, which they provided. Based on its analysis of the information provided, MPI concluded as follows:

- MPI has a well-established, effective, and transparent methodology for selecting its tail factors for Income Replacement coverage;
- MPI’s long-tail experience cannot be directly compared to the long tail experience at SGI or SAAQ in absolute terms because of differences in coverage, reserving practices, and other potential unknown factors, however, MPI’s claims experience behaves very similarly to SGI and SAAQ; and
- While a jurisdictional comparison is informative, MPI did not see any value in changing its current long-tail reserving process. In MPI's view, a more beneficial use of the jurisdictional comparison would be to use this information to model policy liability mis-estimation risk as part of the Dynamic Capital Adequacy Testing (DCAT) exercise.

6.7. Interveners' Positions

CAC

CAC commented that, as compared to peers, MPI's IT staffing budgets appear excessive. CAC recommended that MPI be required to report back to the Board on its efforts to bring staffing budgets in line with peers.

CAC also commented on what it characterized as material challenges with the implementation of major IT programs, such as BI[3] and PDR. Given the potential for ongoing effects on ratepayers, CAC recommended that MPI be required to hold a Technical Conference on the business cases for Legacy Modernization prior to the next GRA filing. The Legacy Modernization business case should include examples of net present value analysis, demonstrating adherence to good business practice.

CAC did comment that MPI had taken a number of steps to introduce standard good business practices to its management of IT expenditures, including the application of a more robust net present value analysis to the PDR, including the CCRS. However, given the limitations with Gartner's prior years' PDR evaluations, CAC would recommend that in the future, any external expert retained by MPI and providing evidence to the PUB should be directed to expressly identify any aspects of their evidence that do not conform with best practice.

CAC also expressed that MPI, as a Crown monopoly, might make imprudent mistakes, such as:

- To rely on BI[3] technology and take a passive approach to complex claims management;
- To have IT staffing levels far higher than the industry average;
- To enter into lengthy information technology "adventures" relating to Physical Damage Re-engineering without appropriate business cases and without disclosing material information to Gartner;

CAC argued that the Board is not required to build a cushion in the rates to account for imprudence, or to pass on unreasonable or imprudent mistakes to ratepayers.

CMMG

CMMG argued that the Corporation is in excellent financial condition, with operating and claims expenses both having decreased. Therefore, the Board should hold the Corporation's "feet to the fire," to ensure it manages its claims and administrations costs prudently.

6.8. Board Findings

The Board has in the past characterized one of the key elements of its independent review function and rate-setting role as ensuring that actual and projected costs incurred are necessary and prudent, in the context of setting just and reasonable Basic rates. The Board's jurisdiction to do so is derived from *The Crown Corporations Public Review and Accountability Act*, and in particular, s. 26 thereof. The Board continues to hold a keen interest in the Corporation's efforts to reduce and contain costs.

The Board acknowledges that the Corporation complied with its directive to seek information on longer tail claims experience from SAAQ, after failing to do so for a number of years.

The Board continues to support the Corporation's cost containment efforts, including its steps taken to reduce operating expenses and optimizing staff levels. The Board finds that the Corporation is continuing to move in a positive direction.

The Board is encouraged by the Corporation's continued efforts to continue to reduce reliance on IT consultants and reduce the number of IT staff overall. The Board acknowledges the new IT Strategy, and understands that it will be updated annually going forward. Accordingly, the Board directs the Corporation to file its updated IT Strategy in the 2020 GRA.

More generally, with respect to IT, previous Board Orders make clear that this has been an issue of concern to the Board for some time. In Order 162/16, the Board expressed concern at the lack of business cases in the IT area.

In Order 130/17, the Board commented that it expected that the Value Management Process would bring in valuable controls and contribute to better business process management in IT. With respect to PDR, the Board found that MPI had not clearly established that the program was in fact operating within its original budget and that the Corporation was challenged in controlling the spending on the program. The Board also commented that the NPV and internal rate of return calculations for the PDR program were of limited value as they did not take into account the costs of operating and maintaining the program, and utilized a 3% discount rate.

The Board also expressed concern in Order 130/17 that the Corporation had not disclosed the costs to operate the PDR program, which the Board viewed as a critical component in assessing the costs and benefits associated with the program.

With the information that was filed by the Corporation in this Application, and with the 2018 Gartner Report, it appears that the Board's concerns about the PDR program were well-founded. The Corporation failed to provide Gartner with all the relevant information and also failed to include the cost of operating and maintaining the PDR program, notwithstanding multiple requests from Gartner. If Gartner had been provided with all relevant information regarding the PDR program, in order for it to prepare its evaluations for the 2017 and 2018 GRAs, it is likely that a more realistic appraisal of the PDR program would have been available sooner. Unfortunately, MPI pursued the PDR program over many years with the result that significant funds were spent on a program which has a NPV of ($49.9) million. The Board does not understand why, in previous years, MPI did not provide Gartner with all relevant information such that Gartner would have been able to perform an accurate and realistic appraisal of the program. The Board is also concerned with the fact that, until this year, business cases were not prepared for the PDR program; what was considered by the Corporation was the "benefits stream."

Given the history of the PDR program, the Board finds that it is important that the Corporation continue to evaluate and report on the program. Accordingly, the Board directs that in the 2020 GRA, the Corporation file an update, prepared by Gartner, to its 2018 PDR Program Evaluation. The Corporation shall provide to Gartner all relevant information such that Gartner will be able to fully evaluate the PDR program's benefits and the costs to operate and maintain the PDR program.

The Board finds that the information filed with respect not only to PDR, but to IT overall, was more thorough and comprehensive in this Application than in previous years. The Board appreciates the openness with which the Corporation provided information on IT in this Application, and is of the view that the Corporation has demonstrated progress in its efforts to rein in spending on IT and to make future strategic IT investments. The Board anticipates receiving information from the Corporation in the 2020 GRA as to the progress it has made in the implementation of the Value Management Process and the IT Strategy.

With respect to Legacy Modernization, the Board declines to order, as was recommended by CAC, that a Technical Conference take place to review this initiative. The Board finds that the Corporation has the capability to proceed with this initiative without the need for a Technical Conference; however, the Board directs that in advance of the 2020 GRA, the Corporation engage in discussions on an ongoing basis with the Board, with respect to progress on the Legacy Modernization project, any business cases created for the initiative, and the establishment of higher-level key performance indicators. The Board directs that in the 2020 GRA, the Corporation provide an update of its progress on the Legacy Modernization initiative, file any business cases created for the Legacy Modernization initiative, and any higher-level key performance indicators

Given the Board's ongoing interest in IT, the Board directs that in the 2020 GRA, the Corporation update all Business Transformation Office-managed projects of $500,000 or more in the 2018/19 Capital Budget.

With respect to staffing in IT, the Board notes that the Corporation continues to rely much more heavily on consultants than its peers. The Board appreciates that the Corporation has challenges in reducing the ratio of consultants to staff given the non-solicitation clauses in its contracts with vendors. The Board understands that these contracts provide a valuable service to MPI, but is concerned that MPI could become overly dependent on its vendors. The Board is of the view that the key to success in this area is effective IT vendor management. The Board therefore directs the Corporation, in the 2020 GRA, to report on its progress in reducing the ratio of IT consultants to internal staff, in particular project management roles, and provide an update as to measures taken by the Corporation to improve the management of its relationships with IT vendors.

Lastly, the Board finds that the benchmarking information provided by Gartner on an annual basis is of great assistance in informing the Board as to MPI's progress in its IT maturity. The Board anticipates receiving an update on the Corporation's IT benchmarking and therefore directs that in the 2020 GRA, MPI file an update to the

Gartner Benchmark Findings and Recommendations Executive Report, including an update to its IT Score with the Board.

7. INVESTMENTS

7.1. Investment Portfolio

The funds available for investment by the Corporation are primarily the assets supporting the unearned premium reserves and unpaid claims reserves. The Corporation's overall investment portfolio was over $2.7 billion as at February 28, 2018. MPI's assets must be managed in accordance with the Investment Policy Statement approved by its Board of Directors.

The recent actual and forecast composition of the Basic investment portfolio is summarized below.

Basic Investment Portfolio				
	2017/18 Actual		2018/19 Forecast	
	Ending Asset Values (C$ millions)	Portfolio Composition	Ending Asset Values (C$ millions)	Portfolio Composition
Cash/Short Term Investments	76	3.2%	-	0.0%
Canadian Fixed Income	1,083	45.5%	1,462	67.1%
MUSH Non-Marketable Bonds*	527	22.1%	554	25.4%
Total Long Term Bonds	**$1,686**	**70.8%**	**$2,016**	**92.5%**
Canadian Equities	226	9.5%	40	1.8%
US Equities/Global Equities	124	5.2%	43	2.0%
Global LV Equities	0	0.0%	33	1.5%
Real Estate	259	10.9%	33	1.5%
Infrastructure & Venture Capital	87	3.6%	16	0.8%
Total	**$2,381**	**100.0%**	**$2,181**	**100.0%**

** MUSH bonds are Manitoba rural municipality, school division and healthcare facility bonds and debentures which are not tradable in the fixed income market. MUSH bonds are held at book value and the portfolio's value does not vary with changes in interest rates.*

7.2. Investment Management

Basic premiums are not set to fully recover claims costs; instead MPI typically depends on investment income to break even. MPI’s substantial investment portfolio is managed jointly by the Corporation and the Province of Manitoba, through a committee known as the Investment Committee Working Group (ICWG), which is co-chaired by MPI's Vice President of Finance and Chief Financial Officer, and the Assistant Deputy Minister (ADM), Treasury Division, Manitoba Department of Finance.

In the course of this Application, the Corporation filed its Transitional Investment Policy Statement, which was prepared as a result of the changes to be made to the Corporation's Investment Portfolio to be implemented following the completion of the Mercer Asset Liability Management Study.

7.3. Asset Liability Management (ALM)

Issues concerning MPI's asset liability management extend back over several GRAs. 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 investment portfolio management, investment portfolio research, economics and risk management, and quantitative asset liability modeling. In Order 162/16, issued following the 2017 GRA, the Board ordered MPI to obtain an updated ALM 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.

MPI did not file an updated ALM study with the 2018 GRA. Rather, in the course of the 2018 GRA hearings, the Corporation advised the Board that it had issued a Request for Proposals for the updated ALM study and engaged Mercer Canada (Mercer) to deliver the study by November 30, 2017, after the conclusion of the 2018 GRA hearing.

In Board Order 130/17, issued following the 2018 GRA, the Board directed the Corporation to file the 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.

The Mercer ALM Study was prepared in three phases, the last of which was submitted in February, 2018, and reports in respect of each phase were filed with the Board as part of the 2019 GRA, together with additional information concerning the Mercer ALM Study and plans for its implementation.

At the hearing, MPI called Dave Makarchuk as a witness to provide evidence on the Mercer ALM Study. Mr. Makarchuk is a partner with Mercer Investments and is Sales and Strategic Growth Leader with the Canada's National Wealth Leadership Team. Mr. Makarchuk is also a Fellow of the Canadian Institute of Actuaries. Mr. Makarchuk was qualified as an expert in the area of institutional investment planning and asset and liability matching.

The three phases of the Mercer ALM study were broken down as follows:

- Phase 1 analyzed the merits of adopting unique asset allocations and investment policy statements for segregated investment portfolios for each of the Corporation's classes of liability, namely, Basic claims liabilities (Basic Portfolio), the RSR (RSR Portfolio), employee future benefits - primarily pension (Pension Portfolio) and Extension coverage claims liabilities (Extension or EXT) and Special Risk Extension claims liabilities (SRE);

- Phase 2 included a discussion of new asset classes along with the rationale for inclusion and exclusion, proposed asset allocations for each portfolio, including estimates of risk and return, and implementation considerations; and

- Phase 3 finalized the responses to Mr. Viola's eighteen (18) recommendations.

In his testimony, Mr. Makarchuk outlined the process by which Mercer undertook the study. Mercer focused on four key factors: 1) expectation of return; 2) tolerance for risk;

3) cost; and 4) time. A review of MPI's objectives clarified the purpose of the assets which, in turn, prioritized the relative importance of each of these four factors.

Two of the Corporation's primary investment goals were to mitigate risk resulting from interest rate variations and to minimize short-term premium volatility. In addition, MPI chose to hedge against nominal, as opposed to real, inflation expectations and interest rate risk.

The key strategic recommendations flowing from Mercer's analysis and MPI's objectives were:

- Segregate the assets based upon each class of MPI's liability;
- Significantly de-risk the assets backing MPI's Basic claims liability;
- Diversify and lengthen MPI's fixed income portfolio;
- Diversify MPI's equity portfolio; and
- Reduce MPI's allocation to real estate assets.

The key expectations flowing from these recommendations were an expected decline in returns (estimated at $11 million/annum) but with an expected decline in risk (estimated at $67 million/annum) as well. Further, it was recommended that the changes to assets and allocation be implemented over a 24-month period.

Modelling to optimize asset allocations was developed based upon conclusions and constraints made by the Corporation which, though not necessarily recommended by Mercer, were supported by Mercer, including decisions to accept the risk as to inflation, hedge against nominal rather than real interest rate risk over the outlook period and accept, reduce and reject certain classes of assets.

In order to evaluate financial risks and to find portfolios that minimize interest rate and inflation risks, Mercer developed a fixed income portfolio that reproduced the fluctuations of the liabilities of the portfolio (Liability Benchmark Portfolio or LBP). Accordingly, the LBP portfolio used by Mercer accepted inflation volatility, assuming a 2% inflation rate that was static throughout the modelling exercise, and hedged against nominal interest rate risk. Efficient frontiers for each of the Basic, RSR and Pension Portfolios were developed to identify optimal asset allocations at each respective level of risk.

The implementation of the recommendations from the Mercer ALM Study will result in the separation of the Corporation's commingled investment portfolio into the five unique portfolios indicated above: Basic, RSR, Pension, Extension and Special Risk Extension. The transition into five unique portfolios is planned to commence at the end of the 2018/19 fiscal year, with the transition expected to be completed by 2019/20. The current portfolio allocation of 70% in fixed income assets (bonds) and 30% in growth assets (equities, real estate and infrastructure) will be in place until February 28, 2019, and the five new investment portfolios will be effective March 1, 2019.

The new allocations based upon the Mercer ALM Study will result in the Basic Portfolio becoming 100% fixed income, the RSR Portfolio becoming a balanced portfolio with a 50% allocation in fixed income, 50% allocation in growth assets, and the Pension Portfolio becoming 40% in fixed income and 60% allocation in growth assets. This results, on a consolidated basis, to 84% in fixed income and 16% in growth assets.

Target asset mixes for these portfolios are:

- Basic Portfolio – (100% Fixed Income) 60% Provincial Bonds, 20% Corporate Bonds, 20% Non-Marketable Bonds (MUSH) (Hedge Ratio to increase from 85% to 100%);

- RSR Portfolio - (50/50 split between bonds and growth assets) 50% Fixed Income, 35% Public Equities, 15% Alternative Investments; and

- Pension Portfolio - (40/60 split between bonds and growth assets) 40% Fixed Income, 35% Public Equities, 25% Alternative Investments.

New asset classes accepted for the RSR and Pension Portfolios were:

- Private Debt – investment grade North American debt;
- Global Equities – includes developed market equities and no emerging-markets; and
- Global Equities (Low Volatility) – less volatility than the standard global equity securities to reduce overall risk of equity portfolio.

As indicated above, real estate assets were to be reduced, and the following assets classes were rejected:

- Diversified Growth Funds;
- Private Equity;
- High Yield Bonds;
- Emerging Market Debt;
- Mortgages;
- Leverage; and
- Real Return Bonds (RRBs).

The Corporation's rationale for rejecting investment in RRBs was because: 1) they are very low yield; 2) a 2% inflation rate was assumed and RRBs will only add value if inflation significantly exceeds 2% for sustained period of time; 3) dollar and duration matching is difficult with RRBs because there are so few available to properly duration match; and 4)

RRBs are linked to Canadian Consumer Price Index while Basic claims liabilities are indexed to the Manitoba Consumer Price Index and industrial average wage.

While acknowledging that a real liability benchmark would better reflect inflation volatility and real interest rate risk, MPI submitted that accepting those risks was a choice made by it as an investor. The Corporation argued that the objectives, risk tolerance and accompanying investments selected by it were patently reasonable.

The Corporation's review of inflation forecasts from the Canadian chartered banks, Mercer, the Bank of Canada, and break-even inflation rates currently implied by RRBs all indicated that inflation will be approximately 2.0% over the outlook period. MPI argued that its Board had established the risk appetite for the Corporation and through the ALM process, decided to hedge nominal interest rate risk, choosing to accept the lesser threat of inflation volatility risk. The Corporation submitted that the Board should defer to the investment decisions of the MPI Board of Directors.

MPI further emphasized that, based on the ALM strategy being implemented by the Corporation, the impact of interest rates on Basic will be significantly reduced going forward.

7.4. Investment Returns

The size of the Corporate investment portfolio was projected to be $2.5 billion for 2018/19, increasing to $2.9 billion for 2022/23. For 2017/18, MPI had investment income for Basic of $116.3 million. Based on the Corporation's proposed use of a Naïve interest rate forecast, the Corporation’s investment income is projected to be $223.5 million for 2018/19, of which Basic’s share is $191.8 million or 85.8%.

As noted above, following the Naïve interest rate forecast as at September 30, 2018, of 2.43% (which reflected an increase of 19 basis points from 2.24%, which was used by the Corporation in the GRA filing), the Corporation updated its projected investment income of $171.4 million for Basic, to offset a revised underwriting income forecast at $28.3 million.

MPI realized a $134.8 million return in investment income in 2017/18, of which Basic's share was 86.28%, totaling $116.3 million in income. The investment returns can be primarily attributed to higher than expected real estate pooled fund returns. MPI's projected allocation to Basic from investment income has not changed materially since last year's application. The actual and projected allocations for Basic are as follows:

Allocation of Investment Income ($ millions) to Basic					
	2017/18	**2018/19**	**2019/20**	**2020/21**	**2021/22**
2019 GRA	$116.3	$191.8	$82.1	$84.9	$87.8
2018 GRA	$101.8	$78.1	$80.0	$85.9	$84.4
Difference	$14.5	$113.7	$2.1	($1.0)	$3.4

The Corporation provided a five-year comparison of its investment returns with those of the Workers' Compensation Boad (WCB), the Teachers' Retirement Allowance Fund (TRAF), and the Civil Service Superannuation Board of Manitoba (CSSB). The comparison indicated that MPI had underperformed the average return for WCB, TRAF and CSSB in 2017 by 2.8%. However, the asset allocations of these funds are very different than the asset allocation of MPI's fund as these funds have much larger allocations to growth assets. In order to make a direct and accurate comparison the asset allocations were adjusted so that they are on the same basis. When the asset allocations of other funds were adjusted to match MPI's, their average return fell to 4.0% in 2016 and 5.9% in 2017, underperforming MPI by 2.5% and .04% respectively.

MPI also provided a comparison of its investment results with those of Saskatchewan Auto Fund (SAF), a comparable public insurer with an investment portfolio of $2.3 billion (versus $2.6 billion for MPI). For the last completed fiscal year March 31, 2018, SAF reported investment income of $162.8 million and $173.8 million for its prior fiscal year, higher returns than those reported by MPI.

As a result of the implementation of the changes arising from the Mercer ALM study, Basic net income is forecasted to increase by $95 million in 2018/19, primarily as a result of the realization of Accumulated Other Comprehensive Income (AOCI) on equity assets due to the sale of assets required to create the unique portfolios. The new ALM strategy will require the Corporation to liquidate all of its US holdings and Canadian equity holdings, in order to make the necessary asset allocation changes required for the five distinct portfolios.

Total equity is forecasted to be lower, as investment asset returns are forecasted to be lower with fewer growth assets. Based on a Naïve interest rate forecast, the Minimum Capital Test ratio will increase by roughly 16% at the end of 2018/19, from 54% to 69%, due to lower capital requirements on the Basic line of business investment assets.

7.5. Interveners' Positions

CAC

Valter Viola appeared again in this GRA as an expert witness on behalf CAC, to provide evidence relating to the Mercer ALM Study. Mr. Viola is a Chartered Financial Analyst and has 25 years of institutional portfolio management, investment research and risk management experience. He was qualified as an expert in investment portfolio management, investment portfolio research economics and risk management, and quantitative asset liability modelling.

In his report entitled *MPI's Investment Portfolio: Asset/Liability Analysis and Previous Recommendations* (Viola Report), Mr. Viola set out his views based upon his review of the Mercer ALM Study and MPI's changes to its investment portfolios based on the study.

The Viola Report sets out eight recommendations, summarized as follows:

- Real Liability Benchmark - Re-examine the reliance on a Nominal Liability Benchmark, rather than a Real Liability Benchmark, given the understatement of the long-term risk of inflation and changing real interest rates that are inherent in the Basic and Pension Liabilities.
- Leverage Constraint - Re-examine the constraint prohibiting the use of “leverage”, given the lower risk adjusted returns that would result.
- Duration Policy “Basis” Risk - Re-examine the effectiveness of the duration policy, which uses (nominal) bonds as the basis for matching the inflation and real interest rate sensitivity of Basic and Pension Liabilities, since inflation volatility is not zero.
- Lengthening Nominal Duration - Re-examine the decision to lengthen the nominal duration in the Basic Portfolio, given: MPI’s “defensive” (lower risk) strategy;

Mercer's return assumptions for bonds and RRBs; and concerns about the effectiveness of the duration policy noted above ("basis" risk).

- Real Return Bonds - Re-examine the decision to exclude RRBs from both the Basic and Pension portfolios, given the better hedging characteristics of RRBs (compared to bonds), recognizing the long-term inflation and real interest rate risks inherent in the liabilities.

- Other Real Assets - Re-examine MPI's recommended reduction in other real assets (real estate and infrastructure), given the low inflation protection that exists in the current portfolio and lower diversification that would result.

- Fixed Income Risk Concentration - Re-examine the decision to concentrate risk in fixed income, rather than better diversify the sources of risk across the whole portfolio, and avoid "crowding out" risk-reducing RRBs. See Duration Policy "Basis" Risk Oversight

- Quantitative Models - Continue to be vigilant about placing too much reliance on quantitative considerations, particularly if risk tolerances are low, given the high sensitivity of optimal asset allocations to capital market assumptions and the large number of inputs involved.

Mr. Viola's primary criticisms of the Mercer ALM Study were the use of a nominal, rather than real, liability benchmark, the rejection of RRBs, and the reduction of real assets as a hedge against inflation and interest rate risk. Mr. Viola expressed his concern as to the constraint MPI had imposed on the Basic Portfolio in particular, i.e. 100% fixed income and no RRBs, came at too high of a cost.

In Mr. Viola's opinion, determining a Minimum Risk Portfolio (MRP) (what Mercer referred to as the LBP) is the first step towards responsible long-term management of the portfolio. The purpose of developing a liability benchmark is to identify and measure the risk of the liabilities and, therefore, it must reflect the true risks inherent in those liabilities (e.g., duration, inflation).

As well, Mr. Viola emphasized that the liabilities of the portfolios define themselves and are not a function of risk tolerance. That is, modeling liabilities is not an investment choice. In his view, the LBP adopted by Mercer conflated the design of a true liability benchmark with the ultimate portfolio selected, and was compromised by assumed capital market expectations, i.e. expected level, as opposed to volatility, of inflation.

In Mr. Viola's opinion, the LBP adopted by Mercer, based on the Corporation's investment constraints, understated the significance of inflation volatility and real interest rate risk, which makes duration management less effective. As such, risk had been misidentified and mismeasured in the Nominal Liability Benchmark utilized by Mercer.

By not capturing this inflation risk, in Mr. Viola's view, the true risk of having nominal bonds support real liabilities was not properly measured. Mr. Viola described this mismatch as "basis risk" resulting in "tracking error". Based upon Mercer's data, Mr. Viola calculated this tracking error between the Real and Nominal Liability Benchmark Portfolios in the Mercer ALM Study to be 4.5% for the Basic Portfolio, which is material given the Corporation's very low risk tolerance of ~3.8% surplus volatility.

Further, the asset allocations that flow from an optimizing process depend materially on whether a nominal or real liability benchmark is selected. In Mr. Viola's opinion, MPI's "free risk" bucket placed unnecessary constraints on the investments and actually resulted in material risk over the long term. According to Mr. Viola a mix of low-risk and risky assets together provides a better risk versus return trade-off than assets concentrated in either one. MPI's determination of short-term rate stability would come at cost of long-term opportunity and create a risk of higher long-term rate instability. In Mr. Viola's view, the focus should be on a full portfolio designed to mitigate longer horizon risks and achieve higher returns by taking different kinds of risks in a prudent fashion. In his opinion, RRBs, which were rejected, and real assets, which were reduced by MPI, are the best hedge against long-term risks.

Based upon the further modelling conducted by Mercer pursuant to Order 124/18, at current risk levels (i.e. a surplus volatility of 3.8%), Mercer's efficient frontier analysis suggested that the expected excess return above the liability benchmark drops by ~0.8% when RRBs are excluded from the Basic Portfolio, and ~0.2% when excluded from the Pension Portfolio. Mr. Viola acknowledged that, for modelling purposes, the excluded RRBs would have been reinvested in other asset classes which might affect the performance of the portfolio and, therefore, the exclusion of RRBs might not fully account for the reduction in the expected return. Further, the reinvestment of the excluded RRBs might be in asset classes MPI had rejected as too risky, such as private equity; however, this could not be determined as Mercer had not provided this information.

Mr. Viola referred to the difference in the expected return for portfolios without RRBs as the "opportunity costs" of rejecting RRBs which, when extended over the outlook period, are significant. Accordingly, Mr. Viola did not share the concerns of the Corporation in rejecting RRBs.

Mr. Viola also testified that, based on Mercer's analysis, the real liability benchmark indicates that the optimal allocation to RRBs for the Basic Portfolio would be ~40% at the current risk (3.8%), increasing to 66% for no tolerance for risk; and for the Pension Portfolio, the optimal allocation would be ~45% at the current risk level and 81% for minimum risk. As well, the Mercer analysis indicates that the optimal allocation to real estate and infrastructure would be ~16% to 20% of the RRB allocation for the Basic Portfolio and 6.5% to 8% for the Pension Portfolio.

Based on the foregoing, CAC argued that the Mercer ALM study was not conducted or implemented by MPI in a reasonable or prudent manner. CAC submitted that there are significant risks of long-term rate instability as well as the likely prospect of lower returns associated with MPI's proposed asset allocation.

Accordingly, CAC recommended that:

- MPI should be asked to revise the current ALM study in light of Mr. Viola's eight recommendations;
- If MPI chooses not to revise current ALM study, a 0.5% annual reduction in rates should be ordered until such time as MPI can establish it selected investment portfolios in a reasonable and prudent manner (noting that this does not reflect the opportunity cost at comparable risk); and
- Further external experts retained by MPI who are testifying before PUB should be directed to identify whether in their professional judgment the methodology is consistent with professional best practice.

CMMG

CMMG also argued that the Board should continue to hold the Corporation's "feet to the fire" to ensure it does a diligent job of matching assets and liabilities, making good investment selections, and managing its claims and administration prudently.

7.6. Board Findings

The Board did not receive the Mercer ALM study until after the 2018 GRA had concluded and reviewed it as part of this GRA.

When it comes to the Corporation's overall investment strategy, the Board recognizes that its oversight role does not extend to directing the Corporation as to the particulars of its portfolio management.

In this Application, the Board received considerable and detailed information regarding the steps it is taking to improve its asset liability management. Based on the evidence presented to the Board, the Corporation had a range of options available to it with respect to its portfolio composition. It appears to the Board that the Corporation has selected from a range of reasonable options for its portfolios as a result of the Mercer ALM study.

The Board received with interest Mr. Viola's critical analysis of the Mercer ALM Study and recognizes the merit in his opinion that the Corporation should have a full portfolio designed to mitigate longer horizon risks and achieve higher returns by taking on different risks in a prudent fashion. It may be the case that the Corporation has foregone an opportunity to hedge against long-term risks by rejecting RRBs and reducing real assets. To that end, to test the reasonableness of the Corporation's portfolio, the Board directs that the Corporation set up and run shadow portfolios for the Basic and Pension portfolios effective March 1, 2019, with the inclusion of Real Return Bonds as part of an optimal bond portfolio mix. Given the numerous variables attributable to such shadow portfolios, the Board directs the Corporation to consult with the Board on the selection and management of the assets chosen for the shadow portfolios. The Board further orders the Corporation to file, in the 2020 GRA, a report comparing the returns of the shadow portfolios with those selected by MPI. The Board expects that the results of that comparison will be of assistance in determining whether the portfolio selected by the Corporation provided optimal returns.

The Board would point out that as set out above, while the Corporation sought Mercer's advice through the Mercer ALM Study, the Corporation then proceeded to put constraints on the Mercer ALM study. The Board is of the view that it would be beneficial for the Corporation to inform itself and the Board as to how the Basic and Pension portfolios would perform had the Corporation not imposed those constraints. Therefore, the Board directs that the Corporation immediately engage Mercer to run shadow portfolios for the Basic and Pension portfolios effective March 1, 2019, without the constraints imposed by the Corporation, and file Mercer's report in that regard in the 2020 GRA.

As is clear from the foregoing, the Board intends to review the results of the Corporation's new Asset Liability Management strategy in the 2020 GRA. Therefore, the Board directs that in the 2020 GRA, the Board file a post-implementation review of the Corporation's new Asset Liability Management strategy. The review should provide an update on the progress of implementation of the new portfolios, the disposition of the existing portfolio to fund new investment classes, interest rate risk exposure changes, investment income reporting changes including the allocation methodology for balance sheet and investment income and Investment Policy Statement changes.

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 Asset Liability Management strategy is reasonable.

8. RATE STABILIZATION RESERVE AND TARGET CAPITAL RANGE

8.1. Purpose of the RSR

By Order 162/16, the Board approved the following definition of the purpose of the Rate Stabilization Reserve (RSR):

> *To protect motorists from rate increases that would otherwise have been necessary due to unexpected variances from forecasted results and due to events and losses arising from non-recurring events or factors.*

8.2. Basic RSR and Total Equity Balances

In its Application, the Corporation requested a Basic Total Equity target capital range of $143 million to $305 million. The lower threshold of $143 million was found to be equivalent to a 34% Minimum Capital Test (MCT) ratio, and was based on an adaptation of the Dynamic Capital Adequacy Testing (DCAT) analysis based on a 1-in-40-year probability level, with routine management / regulatory action, over a two-year time horizon. The upper threshold of $305 was found to be equivalent to an 85% MCT ratio, based on a two-year, 1-in-40 DCAT scenario with no management action.

A summary of the recent actual and expected future, composition of Basic total equity is provided below:

	Actual		**Forecast**	**Projected**	**Outlook**
Years Ending 28/29 February	**2017**	**2018**	**2019**	**2020**	**2021**
Basic RSR Opening Balance	194	99	171	306	324
Basic Net Income (Loss)	(123)	35	135	18	18
Basic RSR Before Transfers	71	134	306	324	342
Transfer in from Non-Basic Retained Earnings	27.8	37	-	-	-
Basic RSR	**99**	**171**	**306**	**324**	**342**
Basic AOCI	82	40	(52)	(44)	(35)
Basic Total Equity	**181**	**211**	**254**	**280**	**307**

As in the past, the Board also looks to the overall financial strength of the Corporation in establishing rates. On an overall basis, as at February 28, 2017 the Corporation reported retained earnings of $261.5 million (including $162.3 million in Extension and SRE) and total equity of $357.2 million (including $176.2 million in Extension and SRE).

8.3. Dynamic Capital Adequacy Testing (DCAT)

The requirements for an actuary undertaking a DCAT investigation for a Canadian property-casualty insurance company are set out in the Standards of Practice promulgated by the Canadian Institute of Actuaries, along with additional guidance provided in Educational Notes. DCAT was developed by the Canadian Institute of Actuaries to address a private sector regulatory requirement for a financial condition report to be prepared annually by the appointed actuary for those insurers subject to that regulation. DCAT tests the forecasted financial strength of an insurer's capital position under a series of plausible adverse scenarios addressing a number of specified, different risk factors.

The Standards of Practice specify that an insurer's financial condition will be deemed satisfactory "*if throughout the forecast period, under the base scenario and all plausible adverse scenarios, the statement value of the insurer's assets is greater than the statement value of its liabilities, and under the base scenario, the insurer meets the supervisory target capital requirement.*"

The annual Basic DCAT investigation undertaken by the Corporation's Chief Actuary and Vice President, Product and Risk Management is done because it reflects prudent best practices in Canada, as a means to identify plausible threats to the Corporation's satisfactory financial condition, actions which lessen the likelihood of those threats, and actions that would mitigate a threat if it materialized.

In general, the DCAT base scenario financial forecast would reflect the best estimate financial forecast of insurance operations. In a Basic context, this generally means the DCAT base scenario financial forecast matches the financial forecast for the contemporaneous GRA.

In the current GRA, this is true in all respects (including the use of a Naïve interest rate forecast) except that the DCAT base scenario financial forecast excludes the expected revenue arising from the Corporation's proposed Net CMP, which gradually rises from about $22.7 million up to $25.6 million on a written premium basis from 2019/20 to 2022/23.

In defending its decision to exclude the Net CMP from the DCAT, the Corporation argued that:

- If Basic has a satisfactory financial condition without a CMP, it should also have a satisfactory financial condition with a CMP;

- It is appropriate to exclude any assumed capital adjustments in the best estimate base scenario forecast until such time that the Corporation brings forward and gets approval for a capital management plan;

- It is not appropriate to include the CMP in the estimation of the Basic target capital range, which is adapted from the DCAT; and

- Exclusion of any proposed capital adjustments in the estimate of the Basic target capital range will result in more consistent year-to-year assessments of the capital targets.

The DCAT investigation included in the current application was otherwise prepared in a manner consistent with prior years. Because Basic's financial forecast, and the DCAT base scenario, both reflect the expected impact of the Corporation's proposed ALM strategy, sensitivity to shifting interest rates and any decline in the market value of equity investments has been significantly reduced for Basic. Nevertheless, a Combined Scenario, reflecting adverse changes to interest rates, equity investments and loss ratios which are estimated to be plausible in aggregate, continues to be identified as the most significant plausible adverse scenario tested in the DCAT investigation, as in prior years.

The Corporation's Chief Actuary concluded that the future financial condition of Basic is satisfactory as at February 28, 2018. In its evidence, the Corporation also indicated that it is presently working on enhancements to its modelling of the risk associated with the misestimation of Basic's policy liabilities, the benefits of which will be reflected in future Basic DCAT investigations.

8.4. Target Capital Analysis

In recent years, through an extensive collaborative process, an approach to estimating a Basic target capital range was developed as an adaptation of the DCAT investigation. At a very high level, the Basic target capital analysis uses the most significant plausible adverse scenario identified in the DCAT investigation to estimate what level of Basic Total Equity is needed at the start of the forecast period such that:

- For the lower threshold, Basic Total Equity remains above $0; and

- For the upper threshold, Basic Total Equity remains above the lower threshold.

In each instance, the modelling is done at a specified probability level for the adverse scenario over a specified time horizon. Over the course of recent years, a consensus had been reached that a 1-in-40-year (or 97.5th percentile) probability level and a two-year time horizon are appropriate for Basic for both the lower and upper thresholds of the Basic target capital range.

In the 2018 GRA, the Corporation requested a target capital range of $201 million to $438 million. In Order 130/17, the Board set a Basic target capital range of $180 million to $325 million for the 2017/18 fiscal year following the consensus approach described above, using an iterative modelling approach and assuming:

- For the lower threshold, the adverse scenario be considered after routine management / regulatory actions (including rate changes and RSR rebuilding fees); and

- For the upper threshold, the adverse scenario be considered after routine management / regulatory actions (including only rate changes and not including RSR Rebuilding Fees).

The previously Board-approved iterative modelling approach tests a specified target capital level against specified adverse circumstances.

In the current application, the Corporation did not follow the iterative methodology, citing the following reasons:

- The lower threshold must be greater than or equal to the minimum capital required to achieve satisfactory financial condition;

- Any target capital methodology must be based on best estimates;

- The target capital analysis must reflect an appropriate time horizon for which the

Corporation can respond to adverse financial events;

- The lower and upper thresholds are calculated before the inclusion of capital maintenance or capital build/release provisions; and
- For the RSR to be effective and reduce the incidence of RSR rebuilding fees, the Basic Total Equity balance cannot be at or about the lower threshold for a material period of time.

The Corporation's proposed modelling approach tests the current Basic financial forecast (in this instance, excluding the proposed Net CMP), shifted to a specified target capital level at the start of the forecast period, against specified adverse circumstances.

The Corporation also elected to estimate the upper threshold based on modelling of the adverse scenario before routine management / regulatory actions.

In the Application as originally submitted, and based on the foregoing approach, the Corporation proposed a Basic Total Equity target capital range of $143 million to $305 million, which it indicated was equivalent to a range of 34% to 85% when expressed in terms of the MCT.

In MPI Exhibit #26, filed in the course of the public hearings, the Corporation provided an updated estimate of the Basic target capital range reflecting market interest rates as of the end of September 2018. This updated Basic Total Equity target capital range was $140 million to $315 million (or an MCT range of 34% to 88%), after correction of a calculation error with respect to the lower threshold was provided in oral testimony.

MPI Exhibit #26 also provided the estimated Basic target capital range following the previously Board-approved iterative modelling approach using a 50/50 interest rate forecast reflecting market interest rates as of the end of September 2018. This alternative Basic Total Equity target capital range was $122 million to $250 million.

8.5. Interveners' Positions

CAC

Dr. Simpson and Ms. Sherry's report, *The Role of the DCAT and Interest Rate Forecasting* (DCAT/IRF Report), addressed the role of DCAT in determining the Basic Total Equity target capital range.

The DCAT/IRF Report reviewed the chronology of various proposals for setting target capital, which ultimately resulted in the current modified DCAT analysis. Of particular note, was the initial establishment of an RSR Range based on a range of Percentage of Premiums (PoP), and later reliance on the MCT ratio. The major shortcoming of those methodologies, according to Dr. Simpson and Ms. Sherry, was that they are not directly linked to the actual risks facing the Corporation. The benefit of the DCAT methodology is that it has a direct connection between specific and justifiable risks posed as adverse events grounded in historical evidence, and the future financial condition of the Corporation.

Dr. Simpson and Ms. Sherry expressed concern that MPI is using an MCT approach to set the lower and upper threshold. Dr. Simpson's criticism of the approach requested by the Corporation was that it is difficult to attach meaning to any specific MCT level in terms of specific risks and associated tolerance levels. The DCAT methodology, on the other hand, captures specific financial risks as they evolve based on analysis of historical evidence and using established risk assessment practices.

The DCAT/IRF Report recommended that the setting of the RSR continue to be informed by the DCAT methodology and PoP. Although the PoP methodology has not been referred to in any recent Board Orders, Dr. Simpson and Ms. Sherry were of the view that they are not aware of any Board Order that explicitly asserts that PoP would no longer be used to set the RSR Range.

Dr. Simpson and Ms. Sherry recommended that the 50/50 interest rate forecast be used to determine the DCAT analysis to establish the RSR Range, as well as the break-even rate indication.

CAC suggested that a distinction needs to be made between rate volatility and rate shock, and argued that the purpose of the RSR is to prevent rate shock, adding that the Corporation agreed that moderate RSR rebuilding fees do not constitute rate shock. CAC also reminded the Board of its earlier conclusion that the RSR should not provide protection against variances on matters within the control of management, such as certain categories of operating expenses.

CAC ultimately recommended approval of a Basic Total Equity target capital range of $122 million to $250 million, based on the previously Board-approved iterative methodology using a 50/50 interest rate forecast updated to the end of September 2018, as reflected in MPI Exhibit #26.

CMMG

CMMG reminded the Board of the significant growth in Basic's target capital range since 2005, a period over which the Corporation confirmed that there were no significant drawdowns of the RSR as a result of insurance issues. CMMG argued that the RSR is already in excess of $200 million, a level far larger than what is needed, given the history of the Corporation in meeting its mandate to Manitobans.

8.6. Board Findings

The Board hereby approves a Basic Total Equity target capital range for 2018/19 fiscal year of $140 million to $315 million, based on the Corporation's target capital analysis updated to reflect market interest rates as of the end of September 2018 (again using the Naïve interest rate forecast). The Board also directs that, for the next GRA, the DCAT base scenario forecast, also used in the Basic target capital analysis, must fully reflect any expected capital adjustments arising from the thorough capital management plan which the Board will also direct to be proposed in the next GRA.

With this decision, the Board recognizes that is has departed from Order 130/17 with respect to the Basic target capital modeling approach. In that GRA, MPI requested a lower target capital threshold of $201 million and an upper threshold of $438 million. The Board approved a Basic Total Equity target capital range of $180 million to $325 million based on an iterative modeling approach designed to test specific target capital levels. The Board acknowledges the concerns again raised by the Corporation with respect to this approach, including:

- That the resulting lower threshold to the Basic target capital range is below the level it believes is required for Basic to have a satisfactory financial condition;
- That the upper threshold to the Basic target capital range should be modeled before routine management / regulatory actions;
- That inclusion of the Net Capital Maintenance Provision in the base scenario financial forecast is not appropriate for Basic target capital purposes; and
- That the assumed capital transfers from the Extension line of business are problematic because they represent amounts that the MPI Board of Directors may be unable, or unwilling to transfer, and assume a subsidization of Basic that is inconsistent with the principle that Basic should be self-supporting.

All other things being equal, the lower the Basic Total Equity target capital lower threshold, the more likely that the need for an RSR rebuilding fee will be deferred. This is because Basic Total Equity needs to fall farther before triggering that outcome. In a similar manner, the lower the upper threshold is set for the Basic Total Equity target capital range, the more likely that the need for an RSR rebate will come sooner, as Basic Total Equity does not need to rise as far before triggering that outcome.

Furthermore, in general terms, and all other things being equal, the narrower the width of the Basic Total Equity target capital range, the more likely that a given GRA will need to request either an RSR rebuilding fee or an RSR rebate, as the narrower range permits less volatility in actual versus expected Basic financial results before triggering one of these outcomes.

These general observations speak to the importance of setting the Basic target capital range to reflect modeling of the risks faced by Basic over an appropriate time horizon and considering the Corporation's appetite for risk.

The Board acknowledges the Corporation's view that adequate capital in the RSR is required in order to permit MPI to provide stable and predictable Basic rates, and recognizes the risks associated with Basic being undercapitalized, leaving MPI and ratepayers in a vulnerable position in the event of severe adverse events. The question facing the Board every year is what constitutes "adequate capital" as the Board is also concerned that rates should not be increased simply to provide the Corporation with a financial cushion. What is required are just and reasonable rates. The Board recognizes, however, that considerable work has been devoted and progress made over many previous GRAs and through a collaborative process with stakeholders on the issue of the appropriate methodology to be used to establish the Basic Total Equity target capital range. The Board is concerned that it is receiving the same positions from the parties year after year, that the level of capital is either inadequate or too generous. The Board would like to avoid re-visiting the same arguments and, rather, would prefer to establish a standard so that the issue can be determined for a longer period than one year and then the results of a standard methodology can be evaluated. To this end, the Board intends to engage the services of an independent consulting actuary with experience in target capital analysis to:

- Engage stakeholders in discussion to understand their respective preferred Basic target capital analysis approaches; and

- Prepare expert evidence for the next GRA setting out their opinion on best practices for Basic target capital analysis purposes.

The Board’s approval of a Basic Total Equity target capital range of $140 million to $315 million, reduced from that approved in Order 130/17, takes into account the clear evidence that the Corporation’s risk profile has been favourably affected by the ALM initiative. The Board's acceptance of the results of the Corporation's methodology in this Order should not be seen as a specific endorsement or rejection of any particular approach to the Basic target capital analysis going forward, as the Board intends to examine this issue further, following receipt of the independent consulting actuary’s expert evidence in the 2020 GRA.

The Board has, in past Orders, expressed the view that the Corporation's non-compulsory Extension line of business should be regulated. One of the reasons for this is the Board's concern that the level of Basic Total Equity could be depleted at a time when the Extension line of business contains significant reserves. However, the Board's concern is alleviated somewhat given that the Corporation intends to bring forward a capital management plan with rules for transfers from other lines of business. The Board will withhold comment in this Order that it be given the jurisdiction to regulate Extension, and will await the review of the capital management plan at the next GRA.

9. ROAD SAFETY

In Order 130/17, the Board indicated that the issue of road safety would not form a significant part of this Application, as the Board had ordered that a Technical Conference take place in early 2019, addressing in depth a number of road-safety related issues. The Board commented that, in addition to the Interveners to the 2018 GRA, Technical Conference would benefit from the involvement of the membership of the Provincial Road Safety Committee and the Board intends to invite those members to participate in the conference.

The Board further commented that it expects that addressing road safety and loss prevention matters in this venue will invite productive discussion and collaboration, such that significant progress in that regard will be demonstrated in the 2020 General Rate Application.

Accordingly, apart from an examination of operating expenses, road safety was not reviewed in this GRA. With respect to road safety expenditures, MPI forecasted to spend $12.7 million in Basic Road Safety and Loss Prevention Programs in 2019/20. The largest component is to be spent on Driver Education, including the High School Driver Education program, followed by Impaired Driving prevention strategies, Auto-Crime prevention strategies, followed by Advertising and Sponsorships, Road Safety Programming, and Road Watch.

The Board did hear from the Corporation that it has discontinued its immobilizer program for 2019/20 as a result of all new vehicles now having built-in electronic immobilizer technology, and that it estimates the related savings to be approximately $1 million. MPI also discontinued the Entry-Level Professional Truck Driving training course, because, it reported, the framework was well-established, and funding was available from other sources.

10. PRESENTERS

The Board heard from a series of presenters at the hearing of the Application. The presenters are not sworn witnesses and were not cross-examined. As such, although the content of the presentations is not evidence, the Board, MPI and the interveners received the information presented for consideration only. As always, MPI will respond to each presenter in writing, with respect to the presentation made to the Board and file a copy of the response with the Board

Nick Roberts - Manitoba Used Car Dealers' Association (MUCDA)

The MUCDA was founded in 1992. The majority of the largest used car dealers from across Manitoba, as well as some new car dealers, are members of the MUCDA, which is the largest trade association representing the automobile dealers Manitoba. The MUCDA is involved in the development of consumer protection legislation, working at both the Ministerial and administrative levels to advocate for the interests of used car purchasers.

Mr. Roberts commented on what is taken into account when policyholders make a claim on a used vehicle. His concern was that, after a collision, while MPI provides coverage for the cost of repairing the vehicle, there is no indemnity for the associated decrease in value when a vehicle has an accident history. From his perspective, buyers will not want to pay the same amount for a vehicle with an accident history as for one that is accident-free.

Mr. Roberts took issue with MPI's policy that the reduction in value to a vehicle after an accident is not a loss that it should cover. He acknowledged that section 50(1) of the Automobile Insurance Coverage Regulation limits coverage to direct and accidental loss or damage, but argued that MPI has wrongly interpreted "direct loss" to mean only the physical damage to a vehicle. He argued that it is the expectation of policyholders that they will be indemnified for the loss of market value to the vehicle, because the loss of market value is a foreseeable consequence of a collision.

Mr. Roberts took the position that the Board can test the impact upon MPI's bottom line that would result if MPI began to pay out claims on the basis that vehicle owners likely expect, which includes the loss in market value.

Jonathan Westcott and Shane Saskiw - TappCar

Mr. Westcott and Mr. Saskiw are the founders of TappCar, a Transportation Network Company (TNC) operating in Manitoba. They appeared before the Board to make submissions about MPI's Vehicles for Hire (VFH) insurance model.

TappCar has been in operation for approximately two and a half years and has completed over three million rides. It has been operating in Winnipeg since March of 2018 and has completed over 100,000 rides. It has also run a pilot project in Steinbach, Manitoba.

Mr. Westcott and Mr. Saskiw described the VFH insurance model implemented by MPI as a "leading product." They advised that they have researched insurance products for TNCs in other jurisdictions, and the MPI product is advantageous for the TNCs and their drivers. In particular, drivers appreciate the flexibility of the four time bands available. Many of TappCar's drivers have purchased all four time bands, but those with lower incomes or those with more demanding full-time jobs appreciate the ability to pay the lower premiums associated with purchasing fewer time bands. The average premium paid by a TappCar driver is $200-$300 per year, which is affordable. Further, they were of the view that requiring the driver to place insurance results in the driver taking better care of the vehicle than if the TNC was required to place all of the insurance. As a result, TappCar's loss ratios are substantially higher in Alberta than they are in Manitoba. In summary, they characterized MPI's product as unique, successful, and affordable. Further, that affordability has fostered a competitive TNC marketplace in Winnipeg.

Charles Reesinck

Mr. Reesinck is a current resident of Winnipeg, who advised that he has also lived in New York City and in Paris. He raised concerns about the issue of noise pollution in Winnipeg, describing it as an epidemic. He advised that Paris has taken action against noise pollution and is not as noisy as New York.

Mr. Reesinck recommended that MPI should collect a premium from ratepayers to account for noise pollution caused by vehicles. He also expressed the view that MPI management should engage in discussions with the Government of Manitoba to address the issue of noise pollution and noise awareness.

11. IT IS THEREFORE ORDERED THAT:

11.1 There shall be an overall 1.8% rate increase in compulsory Motor Vehicle Premiums for the 2018/19 insurance year, effective March 1, 2019 for all major classes combined, which rate increase BE AND HEREBY IS APPROVED. This rate increase is as derived by the Corporation in accordance with Accepted Actuarial Practice in Canada, based on a Naïve interest rate forecast taking into account interest rates as at September 30, 2018, and taking into account the Net Capital Maintenance Provision applied for by the Corporation.

11.2 The Corporation shall file for approval by the Board, within five business days from the date of this Order or such other time as may be agreed to by the Corporation and the Board, a table of indicated rate changes and approved rate changes (i.e., after capping and rebalancing) by Major Class (and overall) reflecting the approved overall 1.8% rate increase.

11.3 MPI’s requests that there be no change in Permit and Certificate rates, Vehicle Premium Discounts, Service and Transaction Fees, or Fleet Rebates or Surcharges BE AND HEREBY ARE APPROVED.

11.4 In the 2020 GRA, the Corporation shall report back on its tracking of interest rate movements and how this has informed its decision on interest rate forecasting.

11.5 In the 2020 GRA, the Corporation bring forward a thorough capital management plan, encompassing the entire Corporation and including the following:

a. Minimum, maximum, and/or target capital level for all lines of business;

b. A Capital Maintenance Provision built into ratemaking;

c. A capital build and release methodology based on the capital targets;

d. Clearly defined policy-based constraints on the speed and magnitude of the combined rate impact of rate changes, capital maintenance, capital build, and capital release provisions;

e. Clearly defined rules on the transfer of capital from other lines of business; and

f. Evolving the basis of estimating Basic's Net Capital Maintenance Provision in a manner consistent with the objective of promoting stability over time in this estimate.

11.6 There shall be a Technical Conference, to be facilitated by the Board at a mutually convenient time and in sufficient time to allow any findings from the Technical Conference to be fully reflected in the 2020 GRA, with the objective of developing a stakeholder consensus around a capital management plan, through discussion of the Corporation's draft proposal.

11.7 The rates applied for by the Corporation in its Vehicles For Hire Rate Application, filed with the Board on December 15, 2017, and approved on an interim basis by the Board in Order 11/18, are hereby approved on a final basis.

11.8 In the 2020 GRA, the Corporation shall report on its claims experience to date for the Vehicles for Hire class.

11.9 In the 2020 GRA, with respect to the Driver Safety Rating system, the Corporation shall report on the progress of its public consultation efforts, its preliminary research on the no or low cost options for rating models, as well as on its decision on whether to proceed with data collection for the higher cost options.

11.10 In the 2020 GRA, the Corporation shall file its updated IT Strategy.

11.11 In the 2020 GRA, the Corporation shall file an update, prepared by Gartner, to its 2018 PDR Program Evaluation. The Corporation shall provide to Gartner all relevant information such that Gartner will be able to fully evaluate the PDR program's benefits and the costs to operate and maintain the PDR program.

11.12 In advance of the 2020 GRA, the Corporation shall engage in discussions on an ongoing basis with the Board, with respect to progress on the Legacy Modernization project, any business cases created for the initiative, and the establishment of higher-level key performance indicators.

11.13 In the 2020 GRA, the Corporation shall provide an update of its progress on the Legacy Modernization initiative, file any business cases created for the Legacy Modernization initiative, and any higher-level key performance indicators.

11.14 In the 2020 GRA, the Corporation shall provide updates on all Business Transformation Office-managed projects of $500,000 or more in the 2018/19 Capital Budget.

11.15 In the 2020 GRA, the Corporation shall report on its progress in reducing the ratio of IT consultants to internal staff, in particular project management roles, and provide an update as to measures taken by the Corporation to improve the management of its relationships with IT vendors.

11.16 In the 2020 GRA, the Corporation shall file an update to the Gartner Benchmark Findings and Recommendations Executive Report, including an update to its IT Score, with the Board.

11.17 The Corporation shall run shadow portfolios for the Basic and Pension portfolios, effective March 1, 2019, with the inclusion of Real Return Bonds as part of an optimal bond portfolio mix. The Corporation shall consult with the Board on the selection and management of the assets chosen for the shadow portfolios.

11.18 In the 2020 GRA, the Corporation shall file a report comparing the returns of the shadow portfolios as set out in Directive 11.17, with those implemented by the Corporation.

11.19 The Corporation shall immediately engage Mercer to run shadow portfolios for Basic and Pension effective March 1, 2019, without the constraints imposed by the Corporation, and file Mercer's report in that regard in the 2020 GRA.

11.20 In the 2020 GRA, the Board shall file a post-implementation review of the Corporation's Asset Liability Management strategy. The review shall provide an update on the progress of implementation of the new portfolios, the disposition of the existing portfolio to fund new investment classes, interest rate risk exposure changes, investment income reporting changes including the allocation methodology for balance sheet, investment income and Investment Policy Statement changes.

11.21 The Naïve interest rate forecast shall be used for rate-setting and the target capital analysis purposes.

11.22 For fiscal year 2018/19, the lower threshold for the Basic Total Equity target capital will be $140 million, based on the results of the Corporation's methodology updated to reflect market interest rates at the end of September 2018 BE AND IS HEREBY APPROVED.

11.23 For fiscal year 2018/19, the upper threshold for Basic Total Equity target capital will be $315 million, based on the results of the Corporation's methodology updated to reflect market interest rates at the end of September 2018 BE AND IS HEREBY APPROVED.

11.24 In the 2020 GRA, the Dynamic Capital Adequacy Testing base scenario forecast must fully reflect any expected capital adjustments arising from the Corporation's capital management plan.

11.25 On or before April 1, 2019, the Corporation shall file with the Board an update on the status of its compliance with all directives in this Order.

Board decisions may be appealed in accordance with the provisions of Section 58 of *The Public Utilities Board Act*, or reviewed in accordance with Section 36 of the Board's Rules of Practice and Procedure. The Board's Rules may be viewed on the Board's website at www.pub.gov.mb.ca.

THE PUBLIC UTILITIES BOARD

"Robert Gabor Q.C."
Chair

"Darren Christle MPA, BA, CCLP, P. Log, MCIT
Secretary

Certified a true copy of Order No. 158/18
issued by The Public Utilities Board

Darren Christle
Secretary

Appendix A

Glossary of Acronyms and Terms

AAP	Accepted Actuarial Practice
Application	2019 General Rate Application
AOCI	Accumulated Other Comprehensive Income
Basic	Compulsory motor vehicle insurance
Board	Public Utilities Board
BW	Bike Winnipeg
CAA	Canadian Automobile Association
CAC	Consumers' Association of Canada (Manitoba) Inc.
CLEAR	Canadian Loss Experience Automobile Rating
CMMG	Coalition of Manitoba Motorcycle Groups
CMP	Capital Maintenance Provision
Corporation	Manitoba Public Insurance Corporation
DART	Driving Ahead in Real Time
DCAT	Dynamic Capital Adequacy Testing
DSR	Driver Safety Rating
Extension	Optional motor vehicle insurance
FTE	Full-Time Equivalent

Government	Government of Manitoba
GRA	General Rate Application
HRMS	Human Resource Management System
HTA	Highway Traffic Act
ICWG	Investment Committee Working Group (MPI)
IT	Information Technology
MGEU	Manitoba Government Employees' Union
Monopoly	Policies that can only be sold by one corporation (MPI)
MPI	Manitoba Public Insurance Corporation
Naïve Forecast	Interest rate forecast reflecting no change in interest rates from current levels
No-fault	Accident benefits not related to the fault of the driver
NPV	Net present value
PDR	Physical Damage Re-engineering
PIPP	Personal Injury Protection Plan
Province	Government of Manitoba
RoadWatch	MPI Initiative to target impaired driving through deterrence and detection including the use of enhanced enforcement
RSR	Rate Stabilization Reserve

SIRF	Standard Interest Rate Forecast
SRE	Optional Special Risk Extension motor vehicle insurance
TNC	Transportation Network Company
VMP	Value Management Process

Appendix B

Appearances

K. McCandless / R. Watchman	Counsel for the Public Utilities Board ("the Board")
S. Scarfone / A. Guerra	Counsel for Manitoba Public Insurance Corporation ("the Corporation")
B. Williams / K. Dilay	Counsel for the Consumers' Association of Canada (Manitoba) Inc. ("CAC")
R. P. Oakes	Counsel for the Coalition of Manitoba Motorcycle Groups ("CMMG")

Appendix C

Witnesses

Witnesses for the Corporation

B. Graham	President and CEO
M. Giesbrecht	VP, Finance
L. Johnston	Chief Actuary and VP, Product and Risk Management
C. Wennberg	VP, Customer Service and COO
B. Bunko	VP, Information Technology
G. Bunston	Manager, Investments
C. Campbell	Director, Finance and Corporate Controller
J. Remillard	Corporate Business Architect
L. Lazarko	Director, Information Technology
D. Makarchuk	Mercer Canada

C. Henry	Gartner Consulting

Witnesses for CAC

Dr. W. Simpson	Professor of Economics, University of Manitoba
A. Sherry	Actuary
V. Viola	Investment Risk and Management Consultant

Appendix D

Interveners

Canadian Automobile Association (“CAA”)

Coalition of Manitoba Motorcycle Groups Inc. (“CMMG”)

Consumers’ Association of Canada (Manitoba) Inc. (“CAC”)

In-person Presenters

Nick Roberts	Manitoba Used Car Dealers' Association (MUCDA)
Jonathan Westcott and Shane Saskiw	TappCar
Charles Reesinck	Private Citizen