MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE CORPORATION (MPI)

2019/2020 GENERAL RATE APPLICATION

HEARING

Before Board Panel:

Robert Gabor, Q.C. - Board Chairperson

Irene Hamilton - Board Member

Carol Hainsworth - Board Member

Robert Vandewater - Board Member

HELD AT:

Public Utilities Board

400, 330 Portage Avenue

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APPEARANCES

Kathleen McCandless)Board Counsel
Robert Watchman)Board Counsel

Steven Scarfone)Manitoba Public
Anthony Guerra)Insurance

Byron Williams)CAC (Manitoba)
Katrine Dilay)

Raymond Oakes)CMMG

Erika Miller (np)) CAA Manitoba

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--- Upon commencing at 9:06 a.m.

THE CHAIRPERSON: Good morning everyone. If we could start, Ms. McCandless.

MS. KATHLEEN MCCANDLESS: Good morning, Mr. Chair and members of the Panel. Just to give you an overview for today, we are continuing with the cross-examination of MPI panel number 2. I expect to complete my cross-examination sometime before lunch this morning. Mr. Oakes will then proceed with his cross-examination and Mr. Williams will then proceed. We expect that Mr. Williams' cross will go into tomorrow morning as well. Thank you.

MR. STEVE SCARFONE: And, Mr. Chair, just so the Panel's aware, Mr. Makarchuk asked if he could work from his hotel this morning given the subject matter of Mr. McCandless' cross-examination this morning. He'll return after the lunch break for the cross-examination from the Intervenor counsel, if that's fine.

THE CHAIRPERSON: Well, I guess the question is if Mr. Oakes has questions for him, he's going to be cross-examining this morning.

MR. STEVE SCARFONE: Yes and --

THE CHAIRPERSON: I don't know, Mr.

Oakes, have you got question -- will you have questions for Mr. Makarchuk.

MR. RAYMOND OAKES: I only had a couple and I can certainly work around that schedule.

THE CHAIRPERSON: Okay, thank you.

MR. STEVE SCARFONE: Thank you, Mr. Oakes.

THE CHAIRPERSON: We'll work around it, thank you, sir. Ms. McCandless...?

RESUMED

MPI WITNESS PANEL 2 - MPI INVESTMENTS/CAPITAL MAINTENANCE PROVISION/RATE STABILIZATION RESERVE/DYNAMIC CAPITAL ADEQUACY TESTING PANEL

LUKE JOHNSTON, Previously Sworn

GLENN BUNSTON, Previously Affirmed

MARK GIESBRECHT, Previously Sworn (np in a.m. portion)

DAVE MAKARCHUK, Previously Sworn

CONTINUED CROSS-EXAMINATION BY MS. MCCANDLESS:

MS. KATHLEEN MCCANDLESS: Thank you. So, for the panel, I will be asking questions about the capital maintenance provision, Dynamic Capital Adequacy Testing and target capital this morning. I do have a couple of smaller areas to cover just following on yesterday and the filing of the second quarter financial report.

So first, if, Kristen, you could please pull up MPI Exhibit Number 22, and that's slide 30, with respect to interest rate forecasting. So with the recent ALM driven investment port -- portfolio changes in addition to significantly reducing interest rate risk, the exposure to a decline in equity investments has also been reduced, yes?

MR. LUKE JOHNSTON: Yes, it has.

MS. KATHLEEN MCCANDLESS: Does the Corporation consider the possibility of a favourable shift in interest rates to be a risk that needs to be kept low?

MR. LUKE JOHNSTON: I'm just thinking about your question here. So, we would model -- like, so, just to be clear, when we do the DCAT exercise we model every state in the world, not just the bad ones. So like, we would model the full spectrum of risk. Obviously there are favourable and unfavourable scenarios. Interest rates increasing, I think we've shown on the new ALM world it's not -- it's not as much volatility as there used to be. Before it used to be quite a bit favourable but -- yeah, I'm not really sure how to answer that other than that we model everything and -- and our most -- most of focus on in terms of risk is on downside, but there -- there is always upsides to every scenario as well.

MS. KATHLEEN MCCANDLESS: Thank you. Kristen, could you please pull up MPI Exhibit Number 24, and that's the second quarter financial report.

And, Mr. Giesbrecht, yesterday you had mentioned that the Corporation is ahead of forecast. Yes?

MR. MARK GIESBRECHT: That's correct.

MS. KATHLEEN MCCANDLESS: And at pro forma 1, which is at the book of documents, Tab 5, at line 31, we see the forecast for 2018/'19 of $135.6 million in net income. Yes?

MR. MARK GIESBRECHT: Correct,

MS. KATHLEEN MCCANDLESS: And so at the end of August Basic net income was $39.4 million, and that's back to the quarterly financial report at page 3?

MR. MARK GIESBRECHT: Yes.

MS. KATHLEEN MCCANDLESS: I think the PDF and the paper copy might have different page references so. So is MPI still expecting to earn a Basic net income of 135.6 million?

MR. MARK GIESBRECHT: Yeah, the -- the trends experienced so far this year would indicate that we are on track. The big number there that's driving that -- that large net income, again, comes back to the realized gains that we are expecting to happen later this year.

MS. KATHLEEN MCCANDLESS: Okay. And that's when MPI expects to dispose of its equity investments, yes?

MR. MARK GIESBRECHT: Right. In preparation for funding fixed income.

MS. KATHLEEN MCCANDLESS: Thank you. I will now move on to some questions about the capital maintenance provision. So I expect, Mr. Johnston, these will be directed to you primarily.

So first, what drives the need for a capital maintenance provision, assuming rate indications recognize the expected return on asset -- investment assets supporting Basic total equity?

MR. LUKE JOHNSTON: So it might be helpful to bring up our initial presentation from yesterday, not that I want to spend a lot of time on it, but towards the end there, I can't remember the slide number. If you could go to -- keep going, keep going. There -- there you go, that's the one. Thank you.

So at least under current forecasts when we set rates based on accepted actuarial practice, we see explo -- well, especially if we return the investment income from the RSR as part of the rate calculation, we would see total equity stay approximately flat, which is what's shown in the second last row of this table.

And to most people they would say, okay, well, what's the problem? You -- you know, the RSR is staying at the same level. The issue right now is that the business continues to grow, so -- again, use the example, if your assets are growing you would have, all else equal, say more equities, which means if there is a stock market crash, you could lose more. So the MCT and the DCAT and other measures would say you have more risk, you should have more capital.

So that's what's -- that's what's being said by the MCT ratio on the -- on the very last row it's saying if we just set rates for the -- the 0.1, we would have a declining kind of strength in our -- in our RSR, as measured by the MCT ratio, and we're just saying that we would like capital to stay at a consistent strength level, for lack of a better word.

MS. KATHLEEN MCCANDLESS: Thank you.

So, Basic's capital position naturally is expected to decline over time, yes?

MR. LUKE JOHNSTON: That's right. And then when SGI came to the technical conference, they actually showed almost the exact same issue. So they -- they -- their public program has the same concern.

MS. KATHLEEN MCCANDLESS: And perhaps you could just elaborate on the reason for that decline over time?

MR. LUKE JOHNSTON: There's a -- there's a few reasons. We don't earn a profit on -- well, at least not on purpose, sometimes we do make profit by -- but by design we're supposed to be breakeven.

And the main reason right now is that assets and liabilities continue to grow, and based on that, they demand a -- a higher capital amount. As I mentioned yesterday, our liabilities are continuing to grow. We -- we expect that will plateau in the next five (5) to ten (10) years. But right now we're still seeing growth in the balance sheet.

And again, if capital stays the same absolute value relative to a growing balance sheet, it -- it would show these declining capitalization rates.

MS. KATHLEEN MCCANDLESS: If the need

for RSR rebates or rebuilding fees is determined annual -- annually through the GRA process, why the need for a CMP? In other words, why not just let each year unfold and then adjust rates after the fact as needed somewhat in the manner like the Corporation is proposing be done through the use of the naive interest rate forecast?

MR. LUKE JOHNSTON: So, going to the purpose of the RSR, a lot of this -- like, obviously, we want capital to protect the Corporation from adverse events, but the other purposes is to -- for rates -- rate stability. So even just talking about the RSR range itself, one -- one (1) way to look at this would be to say, okay, well, MPI has a 70 percent MCT, $250 million of RSR. It's in the range, don't worry about it, just let it go where it needs to go.

However, in -- in that scenario if all forecasts were no, we're going to watch it deteriorate until we get to that surcharge position and then we're going to ask those customers for money to fund it. And we're just saying that there is no reason to do that. We can maintain capital what we see as fairly, like, for all ratepayers over time, and instead of waiting for big trigger points, we can always be moving more gradually towards a consistent target.

In this case, this is more about maintaining the amount, but in the future, we -- we may want to talk about the build and release idea that SGI uses. And, again, same -- same idea. Let's always be moving slowly rather than waiting for really adverse events and asking people for a big -- a big increase.

MS. KATHLEEN MCCANDLESS: Thank you. Kristen, could we please go to RM 4.2.7.

And I just put this in front of you, Mr. Johnston for your reference. This section describes the basis of estimation of the proposed net capital maintenance provision and to paraphrase, it appears that after estimating the negative 1.2 percent rate level impact of the expected return on investment assets supporting Basic total equity, which is the first component of net CMP, yes?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: The resulting overall rate level change of negative 1.1 percent was put through the financial model to determine what rate level change was necessary in order to maintain the basic MCT ratio unchanged over the period from 2018/'19 year end to the 2019/'20 year end, yes?

MR. LUKE JOHNSTON: That's correct. One -- one (1) thing we said last year is that we would like to keep all those components separate so everybody can see them, like, as oppos -- you know, to just combining them all together.

So we know that investment income, the RSR, was a -- like a major topic so we -- we wanted to make sure that was separately shown.

MS. KATHLEEN MCCANDLESS: Thank you. And at lines 3 to 6, you can see that the modelling showed an overall rate change of increase of 2.2 percent was needed to meet this objective, which implies a net CMP of 3.3 percent. Yes?

MR. LUKE JOHNSTON: It -- just -- watching the lang -- the language here. It implies a capital maintenance provision of 3.3 percent and a net CMP of --

MS. KATHLEEN MCCANDLESS: Yes, pardon me. And so that's the difference between the 2.2 percent increase and the 1.1 percent decrease?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: Now, presumably something other than the basic MCT ratio could have been used here? For example, Basic total equity?

MR. LUKE JOHNSTON: It's -- I'm trying to think of other options. So running future DCATs is -- is difficult. So even in the current DCAT report when we're assessing satisfactory financial condition, we take the DCAT indication and say, this is what that dollar amount equates to a MCT score.

And then we assume the DCAT would produce a similar MCT score in the future because we don't really know what the DCAT for four (4) years from now is going -- is going to show and we -- but we believe that it should, based on all the evidence we've seen running it, that it should stay at a relatively consistent MCT ratio.

So really, what we're saying is, even if we wanted to use and were able to, you know, project future DCATs, we think that the MCT -- you know, keeping the MCT the same would be the same as keeping the DCAT indication the same anyways.

So that -- I think we're talking about the same thing but four (4) years from now if we run the DCAT and it's still 250 million indication, or whatever the number is, that could mean a lot of things. We might of -- maybe we just --reduce risk further or whatever, but I think the MCT in the -- is the easiest and -- way to do this.

MS. KATHLEEN MCCANDLESS: So as I understand your evidence then one (1) of the advantages of using MCT is easiest or maybe most straightforward?

MR. LUKE JOHNSTON: Well, we -- as I think everyone is aware, we definitely support using the MCT for capital targets and measurement anyways, but it is a very easy way to -- to measure the capitalization rate. So we would support it.

MS. KATHLEEN MCCANDLESS: Are there any other advantages that you see from the use of the MCT ratio in this context?

MR. LUKE JOHNSTON: Nothing coming to mind other than all the other -- all the advantages that we've already spoke about about MCT in general as a -- as a tool.

MR. MARK GIESBRECHT: I'll just jump in quickly with a couple of comments on that. Firstly, the -- the MCT allows us to measure our capitalize -- capitalization level at any given month or quarter end; that it produces a dynamic number whereas a static number based on total equity or based on a DCAT modelling does not factor in market changes, growth in the business, if we've made changes to our lesson portfolio. And so, if we have a number to start any given year, that number may not be a fair representation of what we need to carry for adequate capital, six (6), nine (9) or twelve (12) months or eighteen (18) months down the road, given changes in the business or in the marketplace.

And so having a dynamic number that moves -- while it's always guided by DCAT modelling, it give us a better way to represent our capital level, and also gives comparability across our comparators and peer groups.

MS. KATHLEEN MCCANDLESS: Thank you. Are there any disadvantages to the use of the MCT ratio in this context?

MR. LUKE JOHNSTON: I'm not aware of any.

MS. KATHLEEN MCCANDLESS: Thank you. Kristen, could you please pull up PUB-MPI-1-76.

And at question (f) the Corporation was asked to prepare an alternate overall rate indication with supporting documentation incorp -- incorporating the results from the part (d) above and the Board approved 50-50 interest rate forecast.

So the determination of the net CMP is sensitive to the interest rate forecast, yes?

MR. LUKE JOHNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And this IR was asking, essentially, for a restatement of the overall rate indication from the 2.2 percent increase to reflect a Saskatchewan style CMP, in combination with the 50-50 interest rate forecast, yes?

MR. LUKE JOHNSTON: I'm -- that's my recollection. I'm going to bring the ques -- whole question up for myself, but that is my recollection, yes.

MS. KATHLEEN MCCANDLESS: And if we turn to the answer at (f). Can you confirm that the result of that calculation was an overall rate indication of 1.9 percent increase. So the 1.8 that we see here in front of you, plus the .1 percent increase for breakeven?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: Thank you. Now, last year the Corporation proposed that the expected return on the investment assets supporting Basic total equity be excluded from the determination of the rate indications to provide a natural source of growth for Basic total equity, yes?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: Given the relative size of the two (2) components of the net

CMP, so, the 1.2 percent decrease for the RSR return and the 3.3 percent positive for the CMP, what does that suggest to the Corporation about its proposal last year?

MR. LUKE JOHNSTON: So, last year we were really stressing to the Board that we needed a way to -- to build the RSR. It couldn't just stay the same -- same number. The idea of -- of capital maintenance wasn't really brought forward in -- like, in terms of -- like the MCT ratio for example.

So what we -- and I'd have to look exactly at what we said last year, but my recollection is that we were saying, we need something to -- to build the RSR, and through these conversations we've probably admitted that maybe the investment income, the RSR, wasn't the perfect method because some years there may be more than you need or it might be not enough.

So that -- my recollection is that that's how the capital maintenance discussion happened and then we had some meetings with the SGI. And so -- so this approach we bucketed them together into something called net because we really feel they're both capital items, you know, one -- investment income's growing it, and then we're looking at a separate provision to say is that enough, "yes" or "no." Sometimes it -- it might be more than enough and other times it won't.

MS. KATHLEEN MCCANDLESS: So essentially, based on the current estimates then it wasn't enough?

MR. LUKE JOHNSTON: That's correct. Thank you, Kristen. Could we please pull up pro forma PF-3. It's also found at Tab 7 of the book of documents.

And this pro forma shows the statement of changes in equity reflecting the applied for overall 2.2 percent rate level change, correct?

MR. LUKE JOHNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And looking at line 25 here on the table, this shows the actual and forecasted MCT ratios for Basic insurance operations, yes?

MR. LUKE JOHNSTON: That's right.

MS. KATHLEEN MCCANDLESS: In the column for 2019 forecast budget, the 70 percent shown at line 25, that reflects the Corporation's expectation for the Basic MCT ratio at the end of the current fiscal year before the rates that are subject of this application take effect, yes?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: Staying on the same line, we can see that the forecasted MCT ratio twelve (12) months later remains unchanged at 70 percent in the column for 2020 forecast, yes?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: Am I right in understanding that this outcome is a direct result of the modelling done for the net CMP. So, for example, preserving Basic's capital position over the year of the application?

MR. LUKE JOHNSTON: That's correct. And -- and just to -- so everybody understands how and why we did that, they're -- in the '19/'20 fiscal year, there's two (2) sets of rates operating the '18/'19 -- the 2018 GRA rates are still earning through. So if -- so if we had a rate increase in that year, which we did, that's flowing through.

And then the outcome of this hearing is going to affect part of that '19/'20 year. We -- we did look and think about whether this should span over two (2) fiscal years because of how policies are earned, but the reason we said no, it shouldn't do that is because -- that the Board could still change 2020 rates which would affect that following year so we want capital maintained over the fiscal year, which -- which rates are written and that -- that's really like a goal seek exercise on the '19/'20 fiscal year to make sure the MCT ratio stays at 70 percent.

MS. KATHLEEN MCCANDLESS: Thank you.

MR. LUKE JOHNSTON: Were the same.

MS. KATHLEEN MCCANDLESS: And then continuing along the same line at 25, we can see that the forecasted MCT ratio remains at 70 percent for yet another twenty-four (24) months after that. So through to the end of the fiscal year 2021/'22, yes?

MR. LUKE JOHNSTON: Yes, and just to be again clear here, there is now a 2 -- a net 2.1 percent capital maintenance provision built into the rate. So we don't want to pretend that it's not there. It -- it's -- once it's in there it stays there until somebody takes it out.

So, we've assumed here that it is -- the rates haven't changed but our expectation would be we would come back next year, remind the PUB that there is a 2.1 percent net capital maintenance provision in the rate still and so that -- that example, let's say, our position improved, we would say okay, maybe -- it doesn't need to be 2.1 anymore, it can be a lower number.

But given that that is already in the rate it would come through as a rate decrease.

MS. KATHLEEN MCCANDLESS: So given then that no other rate level changes beyond that proposed in this application are being modelled here, what does -- what's before us here tell us about the apparent expected stability in the forecasted Basic -- pardon me, what does this apparent expected stability in the forecasted Basic MCT tell us?

MR. LUKE JOHNSTON: This would -- this would tell me at least in the short term that a net capital maintenance provision of around 2 percent is -- is what we -- what we need, and -- yeah, again, that will change over time, I would expect that -- as I talked about the plateauing of Basic liabilities, I would expect that to get smaller over time.

MS. KATHLEEN MCCANDLESS: So would it be appropriate to conclude then that -- that we could expect the net CMP or at least the CMP to remain relatively stable over time?

MR. LUKE JOHNSTON: We would definitely like to see that happen, but that would be my expectation for a couple reasons. Well, we all -- obviously have the monopoly advantage. So it's not like our -- our -- our business -- our volume of business is changing, but we're always -- the intent will always be to come here and set breakeven rates, you know, every -- every year and -- and the capital maintenance provision will be just the -- the -- the additional provision, positive or negative to keep the MCT ratio the same so I wouldn't expect it to jump around much.

MS. KATHLEEN MCCANDLESS: And from the Corporation's perspective, stability in a capital maintenance provision over time, would that be desirable?

MR. LUKE JOHNSTON: Definitely would. It's part of the rate indication, so, from customer or government perspective, I don't think they really care what you call it, it's a -- it's a rate change. So we don't want that flying around all -- the up and down, yeah.

MS. KATHLEEN MCCANDLESS: So then, would it be correct to understand that if a capital maintenance provision is approved with this application for 2019/'20, that in future GRAs one could expect only minor adjustments to the prior years' CMP that would affect the rate level requirement?

MR. LUKE JOHNSTON: That would be our

expectation on the -- on terms of the maintenance provision. Should we get any shocks or -- or things like that, again, it would -- just by way of an example, let's say we had an adverse event. The stock market's trubulent right now and let's say it -- it lowered our MCT ratio to 50 percent. We would not be asking capital maintenance to bring it back up to 70, we would just be asking for it to stay at 50.

So on that basis, I would expect it to remain stable over time.

MS. KATHLEEN MCCANDLESS: Thank you. Kristen, could you please pull up pro forma 10, PF-10, please.

So by comparison to the previous pro forma, this statement of changes in equity pro forma reflects continuation of the current rates throughout the forecast period, correct?

MR. LUKE JOHNSTON: Correct.

MS. KATHLEEN MCCANDLESS: Now, looking at line 25 in PF-10, it shows the forecasted Basic MCT ratio falling over the course of fiscal year '19/'20, from 70 percent to 63 percent. Yes?

MR. LUKE JOHNSTON: Correct.

MS. KATHLEEN MCCANDLESS: What does the magnitude of this decline tell us?

MR. LUKE JOHNSTON: This tells us that -- actually just -- sorry, just stepping back for a sec. So, if we had included the investment income on the RSR, the rate indication would actually be about negative 1 percent. So these numbers would actually be even more declining.

But what this is saying if we just left rates the same, our risk level based on our balance sheet is growing faster than -- than the RSR. So the MCT ratio is declining.

MS. KATHLEEN MCCANDLESS: Thank you. Kristen, could we please go back to PUB-MPI-1-76. And this time with respect to question (c).

And in this Information Request the Corporation was asked to compare its approach to determining the capital maintenance provision to that of the Saskatchewan Auto Fund.

MR. LUKE JOHNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And just for your reference, we can put the answer before you. Thank you.

So, Mr. Johnston, could you please highlight the difference in the two (2) approaches so that proposed by the Corporation as compared to Saskatchewan Auto Fund and tell us why the

Corporation's approach is preferable?

MR. LUKE JOHNSTON: So the SGI approach -- I'm just going to quickly double check exactly what it does, here.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: At a high level, okay, the SGI approach is looking at an average of the capital maintenance requirement over a -- I believe a five (5) year period, or -- or prior years period. And -- and our approaches is -- is just saying, what is the capital maintenance needed to keep the MCT ratio the same in this -- for this group of policyholders?

The -- the reason we like our approach better is that it's specific to -- it's not looking at anything prior to the current policy year. It's just saying, as I mentioned yesterday, this group of policyholders came in. The MCT ratio was 70 percent. When they leave, it should still be 70 percent. They've contributed a fair, in our -- in our view, a -- a fair contribution to maintaining the RSR.

We didn't think it was appropriate to look back five (5) years and -- and look at average, you know, up/down, and then charge current ratepayers that amount. But that's another -- that's another option that -- that SGI used.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: The Saskatchewan Auto Fund doesn't look back five (5) years. It's a five (5) year forecast. Is that your understanding?

MR. LUKE JOHNSTON: Okay. Sorry, my mistake. Yes, a five (5) year forecast.

MS. KATHLEEN MCCANDLESS: Thank you. Is it possible that some factors having a bearing on Basic's capital position in a given forecast year might be unusual and not routine in the normal course?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Yes. So, like, a -- a very good example that would be the implementation of the new investment portfolio. The -- in this case, the time -- the exact timing of the investment portfolio, we've talked about some things, you know, hopefully by Q4, if not, by -- by, you know, by Q1 next year.

In terms of this forecast, there is stability in that -- in the '19/'20 on a forecasted basis. But you're right. If we were to change something dramatically in that year, we would have to try to normalize that in some way to -- to make it appropriate. But in this particular forecast, we're not -- at least in -- in the forecast, we're -- we're not suggesting that anything's changing dramatically to our -- to our risk profile.

MS. KATHLEEN MCCANDLESS: Why would it be appropriate to include any such unusual factors in the determination of a capital maintenance provision?

MR. LUKE JOHNSTON: So -- so ratepayers we're asking them to pay -- to contribute to the maintenance of capital. We're not asking them to fund a change in -- in our risk profile that we've made by choice. That's, I think, the best way I could think of it.

So if -- if we did something that deteriorated our -- our MCT ratio, it wouldn't be right to ask ratepayers to pay for that, like, in -- in the maintenance provision, because that's -- that's a conscious choice by us.

MS. KATHLEEN MCCANDLESS: Is it in

part because of this issue that a longer-term view of the Capital Maintenance Provision has been adopted in Saskatchewan, as far as you know?

MR. LUKE JOHNSTON: That could be one (1) of the -- one (1) of the reasons. It would make sense, yeah, but I -- I don't know.

MS. KATHLEEN MCCANDLESS: Would it be practical to build up an estimate of the Capital Maintenance Provision by modelling only the normal evolutionary forces having a bearing on Basic's capital position?

MR. LUKE JOHNSTON: I -- I believe that's what you're seeing right now. So the -- in the pro formas that you looked at, at least over the forecast period, where you saw the MCT ratio maintained at about 70 percent, that's suggesting that -- that average would -- would be around the 2 -- the net 2.1 percent, you know, maybe with the exception of that last year, I think the MCT ratio drops a bit. But that -- that could also be done.

But based on that -- that pro forma that we -- we looked at it, it appears that that 2.1 percent average is -- is about what it would be, anyways. But -- but again, you're -- the point -- your point is -- is taken. If there was a very obvious thing in the forecast period that was creating volatility, we'd have to find a way to -- to normalize that.

MS. KATHLEEN MCCANDLESS: Thank you. In the recent past, rates were set to achieve an accounting break-even net income, yes?

MR. LUKE JOHNSTON: That used to be how rates were set, yes.

MS. KATHLEEN MCCANDLESS: And with the move to rate setting in accordance with accepted actuarial practice in Canada, one (1) of the expected advantages is improving stability in rate indications, yes?

MR. LUKE JOHNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And that's because the indications are largely -- largely controlled by expected provisions rather than the ebb and flow of income statement accounting entries over a forecast period, yes?

MR. LUKE JOHNSTON: That -- that is one (1) of the reasons, yes.

MS. KATHLEEN MCCANDLESS: How do you respond to the observation that the Corporation's approach to the Capital Maintenance Provision is a move back towards rate setting based on accounting results?

MR. LUKE JOHNSTON: No, I -- I understand the view. So now we're -- based on what we've just gone through, like, in -- in -- through these examples, what we're really trying to goal seek our match to our MCT ratio. That -- and -- and so that is an accounting view.

But again, if -- if we -- even under AAP, the big -- the big issue with our break-even rate-making methodology was largely related to interest rates. We were forecasting changes into the future, positive or negative, and then we were either giving people rate decreases or rate increases based on what was really prior years' experience. AAP fixed that issue.

In terms of capital, though, we have -- it's pretty clear through the MCT and the DCAT what our capital targets are, and I -- I think it's also pretty clear what we would need to maintain them. And so from that perspective, I -- I don't really know what other option we would use other than something like the MCT ratio.

So if -- yeah, I -- I can't think of a better option. I haven't seen one, but -- did you want to add something?

MR. MARK GIESBRECHT: I'll just add (1) -- one (1) comment. While the total equity would be based on, you know, accounting results, the required capital calculation under MCT is based on a number of actuarial, you know, computations based on the -- the risk charges that apply to different assets and different components. So it's not purely based on accounting. There are other factors.

MS. KATHLEEN MCCANDLESS: Thank you. So turning back to PUB/MPI-1-76, which is on the screen before you, at the answer (g), so in this section of the Information Request, the IR cited a reference from the application with respect to the Corporation's intent to bring forward a capital maintenance plan with the next GRA involving a CMP along with a capital build and release provision, yes?

MR. LUKE JOHNSTON: Unfortunately, these two (2) -- so these sets of words have the same abbreviation. So, the Cap -- Capital Management Plan will -- will have to find a better -- it just can't be called CMP, too, but anyways, we are -- we are coming with the Capital Management Plan.

MS. KATHLEEN MCCANDLESS: And what is the purpose of a capital build and release provision, and how might this work in conjunction with the target capital range currently in use for Basic?

MR. LUKE JOHNSTON: Yeah. This is something that we want to get right, obviously. So there -- there's a -- there's a few different ways to think about it, and I'm sure there's other ones.

SGI model has a target, and when you have a target, it's -- it's a little easier to figure out how you want to move to that target, and what pace you want to move towards that target. When we -- we -- it's given that we have a range, now we have to ask the question, do we only trigger movements when we're out of the range? So that's one (1) view, or should we maybe target to be in the middle of the range would be another, I think, reasonable view.

So that -- that's one (1) of the big -- big questions to answer. So let's say that we decide that the middle was the best place to be. And the -- the reason I would say the middle of the range is logical because we're saying we don't want to trigger frequent rebuilding fees or rebates. So the farthest point away from either of those things should be the middle of our RSR range, in -- in theory.

So just through a hypothetical, use -- if we use something similar to SGI, we might say, how far are we away from the middle? Let's always move towards that one-fifth (1/5) of the way. We might add a cap to that and say -- right? If -- if that one-fifth (1/5) away is, like, a 7 percent rate increase, well, that's a bit more than we can stomach. Let's, you know, one-fifth (1/5) of the way, subject to a cap of -- of some number. That -- those are some of the things that we're thinking about internally and -- and tend to bring forward.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Thank you. Is the Corporation able to share anything today with respect to its progress towards developing a capital maintenance plan proposal -- management, pardon me?

MR. LUKE JOHNSTON: A management plan? Well, I -- I shared some of these items. Other components of it would -- would relate to things like transfers between the lines of business, profitability of the other lines of business, the -- the conditions, you know, when -- when those -- when those things happen.

I don't really -- other than telling you that we're looking at those things, I don't know really what else I can say, but there are --

obviously, the decisions we make here are important, to know this is the -- these are the rules, and -- and they're clear. And when we have that clarity, or if we have that clarity, it's easier to move on the other lines as well, right?

So if we know that we have AAP break-even, we have a capital maintenance provision, this is the rules on how the targets are set, we can say, okay, given that we know that, you know, does -- do Extension profits need to be here? You know, when would we transfer money over for -- from the other lines? Things like that, and -- and our -- our hope would be that that could be something that we would share with everybody, so that's not -- so it's known that those discussions are -- are happening internally right now.

MS. KATHLEEN MCCANDLESS: Thank you. In his evidence, Mr. Graham indicated that he expects the Corporation to come forward in the future with a Basic target capital level rather than a range. Is this expectation tied to the intent to propose a capital management plan?

MR. LUKE JOHNSTON: So Mr. Graham is obviously stating his desired state. So that -- I think it's important that the Board hears what --

where he would -- or himself and the Board and -- and would like to go. But that can look a lot of different ways.

So if we -- if that's something that MPI as really -- having that target for the purposes of a capital management plan, again, maybe that's the middle of the range. Maybe we have some other ideas on how that would be determined, but that -- it'd be on -- within the confines of -- of what's been decided in the regulatory environment.

MS. KATHLEEN MCCANDLESS: Thank you. I -- I'm now going to move onto some questions about Dynamic Capital Adequacy Testing, and target capital.

First, I'd like to ask a few questions about capital adequacy as set out in the Q2 financial report. So, at page 2 -- it's page 2 of the report itself -- it may be different. Yes. In front of -- in front of you here, on the -- there's a graphic on the right-hand side of the page here, under the heading of organizational health. And we see the second graphic down is the capital adequacy minimum capital test for Basic. It's hard to see on the screen before you, but it does say "Basic" there.

And for a target for Q2 '18/'19, the stated target is an MCT of between 75 percent to a hundred percent. Can you explain the basis for this target?

(BRIEF PAUSE)

MR. MARK GIESBRECHT: So this target range, which is published in the quarterly report is our -- our desired end state. It is not aligned to our current framework. It is a longer-term view towards what management and Board is looking for in terms of our -- our desired end state.

MS. KATHLEEN MCCANDLESS: Thank you.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Then on page 3, for total equity, and page -- maybe page 4, pardon me, just at the top of the page, there, at the second line in the second paragraph, we see at the end of the second quarter, Basic insurance reported total equity of $253.5 million, yes?

MR. MARK GIESBRECHT: Yes.

MS. KATHLEEN MCCANDLESS: And given the forecast for the remainder of the year, where does the Corporation expect its retained earnings and total equity to land?

MR. MARK GIESBRECHT: Yeah. We'd have to pull up the -- the pro formas, the total equity section. That would be our -- our best place to -- to gather that number.

MS. KATHLEEN MCCANDLESS: That'd be PF-1, at tab 5 of the book of documents, or --

MR. MARK GIESBRECHT: That'd be PF-3 or 4, I believe.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Right under -- at line 13, in your 2019 forecast budget? Is that right?

MR. MARK GIESBRECHT: Yes.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Thank you. And then just back to the quarterly financial report, we see again at paragraph 2, under "total equity," with respect to Extension, we have -- at the end of the second quarter, Extension insurance reported total equity of $129.3 million, yes?

MR. MARK GIESBRECHT: Correct.

MS. KATHLEEN MCCANDLESS: And just above that, it says that Extension's current capital target level for total equity is $64 million, yes?

MR. MARK GIESBRECHT: Correct.

MS. KATHLEEN MCCANDLESS: So if operations unfold as planned for the second half of the year, does the Corporation anticipate having a significant balance above its needed capital target for Extension?

MR. MARK GIESBRECHT: As it pertained to Extension, there will be a surplus, yes.

MS. KATHLEEN MCCANDLESS: And then with respect to special risk Extension, we see that the current capital target level -- level for total equity is $65 million?

MR. MARK GIESBRECHT: Yes.

MS. KATHLEEN MCCANDLESS: And at the end of the second quarter, the special risk Extension insurance reported total equity of $93.6 million, yes?

MR. MARK GIESBRECHT: That's correct.

MS. KATHLEEN MCCANDLESS: Thank you.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Now if we could pull up DCAT 1.2, and this is just here for your reference, Mr. Johnston. The base scenario financial forecast in the DCAT uses a significantly different modelling assumption from that of the GRA in the DCAT -- in that the DCAT base scenario does not include the Corporation's proposed Capital Maintenance Provision, yes?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: And why is this difference made by the Corporation?

MR. LUKE JOHNSTON: So our view on -- so -- so there's a couple things happening, here. We want the -- the targets calculated from the DCAT to reflect what we've agreed to with the -- the Board, and from -- from previous hearings. The -- the minimum to be at least a requirement for a satisfactory financial condition, and then a range above that number for which we can manage capital.

If we -- so -- so that -- those two (2) numbers give us two (2) kind of risk -- risk measures, the absolute minimum, and then the operating level. The CMP is supposed to help us stay in that range. So we've calculated the -- the lower and the upper, and now we'll say we're in the range, and we don't want to naturally deteriorate out of it. We want to stay within those targets.

If we put the CMP in the calculation of the lower and the upper target, well, then, it pulls all the targets down. It's contrary to the whole point of the -- of the CMP.

So in the same way -- so I'll -- I'll give a different parallel. If we had MCT based targets, and -- and it -- you don't want it to be between a hundred percent and 150 percent MCT, we wouldn't use the Capital Maintenance Provision to say, we need lower targets. We're using it to say, you know, we're at 120 percent MCT, and we want to stay there.

So that was our -- that's our explanation, here, and I think it -- it makes sense that the -- the maint -- maintenance of capital shouldn't reduce your capital targets, in our view.

MS. KATHLEEN MCCANDLESS: In the context of my question, we were referring to the DCAT, not -- so not targets.

MR. LUKE JOHNSTON: I'm sorry, can you repeat that, the --

MS. KATHLEEN MCCANDLESS: The question itself, or my clarification?

MR. LUKE JOHNSTON: The last question that you -- yeah.

MS. KATHLEEN MCCANDLESS: Yeah. So in the context of your response, you were talking about targets, but --

MR. LUKE JOHNSTON: M-hm.

MS. KATHLEEN MCCANDLESS: -- the question posed was -- was with respect to the DCAT.

MR. LUKE JOHNSTON: In -- in terms of the traditional form of the DCAT, not for target base purposes, it's -- it's not included in that -- in the test. We also have never had this approved either, so that's another reason that you may not con -- include it.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Kristen, could we please go to PUB/MPI-2-11.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: And the question posed to the Corporation here was whether if a suitably defined and Board-approved methodology for determining the CMP is established, why would it be inappropriate to include the CMP in the DCAT base scenario as part of a best estimate forecast of Basic financial results, yes?

MR. LUKE JOHNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And to summarize the Corporation's response, which is included at the bottom, here, of the page, and running onto the -- I believe onto -- no, it's all contained on one (1) page -- the response itself focuses on the target capital analysis rather than the DCAT, yes?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: With this in mind, can the Corporation explain why it would not consider inclusion of an established, well-defined, and Board-approved capital maintenance provision to be part of a best estimate financial forecast for DCAT purposes?

MR. LUKE JOHNSTON: I think that's a -- a reasonable question. As you've mentioned, we've clearly focused that -- on the calculation of the -- the capital targets. And our view isn't -- hasn't changed on that. Like, this, like, we -- we definitely think capital maintenance should be left out of that calculation. Otherwise, to me, it defeats the purpose.

But if there is an approved capital maintenance that we can confidently assume is in the forecast, I would agree with you that the -- the base DCAT scenario should -- should have it in there, and you would have in -- in theory, a lower requirement for a satisfactory financial condition.

MS. KATHLEEN MCCANDLESS: Would you agree that the inclusion of a capital maintenance provision in the DCAT base scenario would strengthen the forecasted Basic capital position?

MR. LUKE JOHNSTON: Yes, it -- if one (1) of the other reasons for excluding it, particularly this year, in -- in the measurement of the amount needed for satisfactory financial condition is that if it is in there, the -- the requirement wouldn't be less. So I can confidently say that -- that what is currently in the base is enough, even if we don't get it. Yeah.

MS. KATHLEEN MCCANDLESS: So in effect, would that make it easier for Basic to achieve a satisfactory financial condition?

MR. LUKE JOHNSTON: Yes. Yeah.

MS. KATHLEEN MCCANDLESS: Kristen, could we please pull up PUB/MPI-1-17, and question (a).

This Information Request asked why the Corporation believes that the inclusion of the CMP in the DCAT would likely lead to a reduction in the assumption of the 2.0 percent maximum RSR rebuilding fee as a routine management regulatory response to an adverse scenario, yes?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Sorry. Our answer to part (a), yes.

MS. KATHLEEN MCCANDLESS: And in its response at page 2 of the Information Request, the Corporation stated -- I believe it's at the bottom of the second paragraph, about four (4) lines up from the bottom.

"The need to reactively respond to adverse events with successive 2 percent surcharges and/or rate increases is reduced."

Which sounds like the modeling of RSR rebuilding fees as a routine management regulatory response will likely happen less frequently, rather than being modeled at something less than 2 percent.

Could you please clarify the Corporation's response?

MR. LUKE JOHNSTON: Yeah, so we're -- we're effectively proposing a transition between different rate setting capital environments here. So we're admitting that some of these past needs to do rebuilding fees and then the management action would be different.

So, if you have a capital maintenance automatically occurring and it's giving you about 2 percent, is it right -- appropriate to assume you're going to have these 2 percent rebuilding fees? May -- maybe not. Maybe not the same amount. So that would be another thing that would need to be flushed out of the capital management plan.

What -- what those rules are, again, we don't -- we don't have them, but that would further fine-tune the DCAT to reflect what would really happen if -- if an adverse scenario occurred. And as you know, that's an important part of determining the impact, right?

So when I spoke earlier, if we were to decide that it's okay to stay in the range and just maintain the capital, then the model would do that. But if we're always moving one-fifth towards the --

the target and we had a scenario way, that's how long it would take you to move. So, some of those things are to be determined, and we're essentially saying that here.

MS. KATHLEEN MCCANDLESS: Thank you. Kristen, could we please go to PUB-MPI 1-19, question (a).

And there's a quote from the Corporation at the beginning of the question, and then the Corporation was asked to outline the direction and nature of the planned research with respect to the policy liabilities and indicate whether this would include a consideration of the DCAT prepared for Saskatchewan Auto Fund if made available.

And the Corporation's response is on page 2, and it makes reference to policy liability. What is policy liabilities' risk in the DCAT context?

MR. LUKE JOHNSTON: So we -- we've seen pretty big swings in policy liabilities come through the GRA, basically, the actuary has provision put up for policy liabilities and through changes and trends or -- or that -- that estimate it wasn't -- wasn't right.

So a good -- two (2) kind of extreme examples, I guess, would be the large rebate that happened around 2010, there was a decision there that claimants weren't, you know, living as long as the -- the assumptions assumed and they needed to be changed. So those assumptions were changed and all the estimates were lowered; that triggered a major change in the policy liabilities.

In more recent times we talked about how there is more claimants becoming lifetime claimants. And you know, we used to have about 40 or 50 claimants becoming life and now all of a sudden it's 70 or 80. That was never assumed by the actuary to happen, so we had to increase our liabilities in the last few years.

That would be an unfavourable change in the estimation of liability. So there's a couple examples of how -- now -- so the DCAT, if it's doing its job, should try to estimate what those swings could look like and have a permission for that.

MS. KATHLEEN MCCANDLESS: Thank you. What has triggered the Corporation's intent to undertake further research into the modeling of policy liabilities risk?

So, is this being done in the spirit of continuous improvement or is it in response to a specific concern?

MR. LUKE JOHNSTON: This -- this question continues to come up, and it's -- it should be part of the DCAT, no question.

The -- there's a few things that have stalled the analysis. One, we struggle with how to create a model that can be approved in this -- in this realm. And what I mean by that is, how can we -- what evidence can we provide in the modeling that -- that would be approved through the collaborative exercise.

The -- the other issue that we have is the recent experience is extremely volatile. So again, I mentioned the really large rebate that we had and some of the recent experience. We don't believe that that experience reflects the go-forward risk of liability volatility.

So we wouldn't want to come to this Board and suggest that we need this enormous number for volatility that we don't think is going to continue.

And -- and then -- yeah, the last piece would just be how to model risk in a really unknown period. So, possibly one of the biggest risks that we have would be that -- that the lifetime claimants just live longer than we think they're going to live.

We don't -- we have 20 years of PIPP,

but some of these folks may live forty (40) years into the future, if there is medical technology changes and such we could be wrong.

But going back to my first point: How do we bring that to -- to this Board and say, well, we think we could be 10 percent wrong, so we'd better put up another 50 to 100 million in the RSR for that reason, and what's -- what's my evidence, right? And how do I prove that through the collaborative process that we've had. So that -- that's a big issue that we're trying to work through.

MS. KATHLEEN MCCANDLESS: So to clarify, the Corporation doesn't model policy liabilities risk in the current DCAT, yes?

MR. LUKE JOHNSTON: We, essentially, model the volatility of the experience and -- in given loss years and then risks related to interest rate impacts.

But we don't, for example, have a mortality risk provision or something like that, and that's -- that's what's being talked about here, that -- how do we use the data that we have to come up with something that could be approved and reasonable in this process.

MS. KATHLEEN MCCANDLESS: In the

current modeling you do not consider policy liabilities risk as significant adverse risk scenario, correct?

MR. LUKE JOHNSTON: Currently we do not.

MS. KATHLEEN MCCANDLESS: Thank you. Now, moving on to a couple portions of your presentation yesterday, Mr. Johnston, with respect to capital targets. So if we could pull up MPI Exhibit 22 of slide 29.

Now first, does the Corporation support the objective of setting Basic capital target lower and upper thresholds based on modeling of risk -- of Basic's risk profile?

MR. LUKE JOHNSTON: Sorry, there was a question just do we support the current methodology? Is that -- I -- sorry.

MS. KATHLEEN MCCANDLESS: No. Whether the Corporation supports the objective of setting the target capital lower and upper thresholds based on modeling of Basic's risk profile?

MR. LUKE JOHNSTON: In a general sense, we do. And I say "in a general sense" just because everybody knows we've come to this Board and asked for 100 percent MCT and -- and you've seen it in other documents.

So there is still a concern that the capital targets that we're generating are not in line with other insurers and other Crowns, but as a -- in a general sense, yes, we want targets that reflect risk.

MS. KATHLEEN MCCANDLESS: Thank you. In this GRA, MPI's proposed Basic target capital range when -- when expressed in terms of the MCT, as we see on the table before you on the right-hand side, it goes from 34 percent to 85 percent, yes?

MR. LUKE JOHNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And since this range is entirely below 100 percent, does the Corporation agree that an MCT ratio of 100 percent as either a target capital level, or an up -- upper threshold of a range is excessive based on current modeling?

MR. LUKE JOHNSTON: So that -- that's also an issue that we brought up at -- at these hearings. We have a model and we do our best to have that reflect MPI's reality as much as possible.

The -- the Made-in-Manitoba model has its limitations. It doesn't have, you know, the complete data available to, say, the federal regulator that might be used in a MCT test calculation.

That -- that has been our concern in the past, just to recognize that this is a Made-in Manitoba model, I think it does a pretty good job but to suggest that we know as much as the federal regulator would probably be a stretch.

MS. KATHLEEN MCCANDLESS: Thank you. Can we please go to slide 27.

Now, the MCT ratio for Saskatchewan is found in the middle of the graph for you, yes?

And the ratio shown for Saskatchewan is a target capital level for Saskatchewan Auto Fund and not a minimum, as labelled on this slide. Agreed?

MR. LUKE JOHNSTON: It is a target, yes.

MS. KATHLEEN MCCANDLESS: So unlike MPI, which goes through this annual GRA process, Saskatchewan Auto Fund only gets rate adjustments periodically when Cabinet directs that that process should occur, agreed?

MR. LUKE JOHNSTON: My understanding is that, yeah, they don't have to come every year. How it actually happens, I don't know. But it's not as -- not annual like us, it doesn't have to be.

MS. KATHLEEN MCCANDLESS: So Saskatchewan Auto Fund may be left at a given rate level then for several years, yes?

MR. LUKE JOHNSTON: My understanding is that is actually what is currently happening. I think it's maybe 2014 since the last time that they've had a -- a rate hearing.

MS. KATHLEEN MCCANDLESS: And so Saskatchewan Auto Fund has no direct control to seek rate level adjustments, correct?

MR. LUKE JOHNSTON: Can you repeat that, sorry.

MS. KATHLEEN MCCANDLESS: So as a result of the process in Saskatchewan then, Saskatchewan Auto Fund may be left at a given rate level for several -- several years, as you noted, with no direct control to seek rate level adjustments?

MR. LUKE JOHNSTON: Correct.

MS. KATHLEEN MCCANDLESS: So would you agree that this creates a risk for Saskatchewan Auto Fund then that is not faced by MPI's Basic?

MR. LUKE JOHNSTON: Sorry, you're going to be annoyed with me, but I didn't hear that. Sorry.

MS. KATHLEEN MCCANDLESS: So given what we just discussed then, does that not create a risk for Saskatchewan Auto Fund that's not faced by

MPI's Basic insurance?

MR. STEVE SCARFONE: I just -- I want to just interject, Ms. McCandless, on this line of questioning, appreciating that it's difficult for Mr. Johnston to know what risks SGI might face or what situation SGI is in as it concerns their need for capital and the Cabinet approval that you mentioned earlier.

So just -- I wanted to make that -- not an objection, but just for the witness to appreciate that it's difficult for -- for you to suggest would -- what SGI may be faced with.

MR. LUKE JOHNSTON: I can com -- comment in general term -- like, how I would view this.

If SGI has an option about whether they would like to come and have a rate hearing or not, however that mechanism occurs, that, to me, is less risk for them. And I -- I'll explain why.

Because if they need a rate increase they can come. If they don't, they can ride out profitable business and -- and grow their capital. So I -- I think everyone understands what I'm saying.

So that -- I don't know if I necessarily see it as a risk that -- to them.

MR. MARK GIESBRECHT: Let me -- I'll just try to clarify a bit again.

My understanding is that SGI -- while they don't come forward every year for rate approval, they have the ability to, should they require one.

So if they have not come in -- in a number of years it's because they haven't had a requirement, given their financial condition and -- and the state of their pricing, but if they needed to, then that would be an option too, is my understanding.

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: Thank you. Mr. Johnston, are you aware of whether or not Saskatchewan Auto Fund's target capital level was based on modeling of its risk profile?

MR. LUKE JOHNSTON: My understand -- my understanding is that modeling was done. Their DCAT at least to date for myself has been proprietary.

MS. KATHLEEN MCCANDLESS: Noting the time, I estimate, again, with the caveat that my estimation may not bear out to be accurate, roughly fifteen (15) to twenty (20) more minutes of questioning. So we can continue on or we could take a break.

THE CHAIRPERSON: Sorry. Let's continue.

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: Thank you. So, continuing to look at slide 27 on the left-hand side of the page, there's a box that states "modify DCAT."

And to be clear, this is a reference to the Board's iterative target capital analysis approach, yes?

MR. LUKE JOHNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: The second bullet there makes reference to a significant subjectivity in assumptions.

Is this statement trying to make a distinction from the related DCAT?

MR. LUKE JOHNSTON: Really what it's saying is so we -- there are different options here.

So let's say we -- we decided to use 100 percent MCT as the -- on the basis that it's well-established federal standard and what -- what makes MPI different. Okay, so that -- let's -- let's say that was the view.

There is no subjectivity in the MCT 100

percent calculation, just pull the information right off the balance sheet, compare it to other insurers, it's quick and it's ready. And I think everyone can trust that the federal regulator is doing a good job.

On the DCAT, it's our -- it's our Made-in-Manitoba solution. It is the models that we've created through the collaborative process. We've -- not everyone has been here but we've been in here and fought it out about what inflation should be and what part of the stock market history should be in and what should be out and things like that and, you know, how fast you should react to things, what the management action -- you know, we've heard people say just, you know, assume 10 percent management action and that kind of stuff.

So, we've had those kind of debates, which essentially lands on a level of subjectivity that isn't in the MCT 100 percent capital required calculation. So that -- that's all we're saying there.

MS. KATHLEEN MCCANDLESS: So to clarify then, it's not a distinction between the iterative approach the DCAT and the regular DCAT approach?

MR. LUKE JOHNSTON: We have -- we have

no objections to the iterative method being proposed. On the modified DCAT there was that one (1) piece that we -- we brought up a few times about not liking how the -- the assumption of capital transfers has to occur. Outside of that, no other issues.

MS. KATHLEEN MCCANDLESS: So then the assumption of capital transfers is -- is referenced here at the third bullet.

Is this then to clarify a reference to creating a modified base scenario to reflect a best estimate forecast of Basic operations working consistently at about a selected target capital threshold level?

MR. LUKE JOHNSTON: There's probably only a few people in the room that understand any of that. But yes, yes, that is what that -- that means.

MS. KATHLEEN MCCANDLESS: Is it fair to say that these capital transfers are the means by which the modified base scenario is modeled, rather than a working assumption?

MR. LUKE JOHNSTON: Okay, I think you said that this is the difference in the modified DCAT -- is that the main difference in the modified DCAT rather than using the -- the regular forecast? Is that...?

MS. KATHLEEN MCCANDLESS: The question is with respect to the capital transfers and whether it's a modeling approach or just an assumption?

MR. LUKE JOHNSTON: Oh, it's tough to say. It -- it is definitely part of a modeling approach, but then we also feel like it's an assumption as well, because you do have to create transfers and then we look at those statements and kind of wonder how they're -- how they're valid or if they're appropriate. So maybe a little of both.

MS. KATHLEEN MCCANDLESS: So is the source of the capital transfers of any relevance to the target capital analysis?

MR. LUKE JOHNSTON: The source? I guess we're saying any source is inappropriate because we want a capital target that purely reflects Basic, at least for -- in the presentation and calculation of that number.

And -- some -- very similar to the whole idea of capital maintenance, like, let's calculate the targets first in the absence of any kind of maintenance transfer, rebuild, release, and then after that consider those things, but don't change the targets themselves because of those items.

MS. KATHLEEN MCCANDLESS: Thank you.

Now, some more questions with respect to target capital analysis. And we expect that there will be a need for further questions with this -- in this area once we've received the response to PreAsk number 1.

But for the time being, so first, do the standards of practice of the Canadian Institute of Actuaries specifically address doing target capital analysis work?

MR. LUKE JOHNSTON: Not having that at my fingertips, nothings coming to mind. If you have a reference, I'll look at it.

MS. KATHLEEN MCCANDLESS: That's fine, thank you.

So what does it -- what would it mean then when an actuary says that they are carrying out this kind of work in accordance with accepted actuarial practice in Canada?

MR. LUKE JOHNSTON: Well, for me it would mean just that we're -- we're making best estimates and performing all these calculations in -- you know, within what you expect from actuarial standards on any ca -- calculation that an actuary would perform and sign their name behind.

MS. KATHLEEN MCCANDLESS: Now, if we could turn to PUB-MPI 1-16, question (c) of this

Information Request.

So in this question the Corporation was asked about what concerns it has with respect to the Board approved iterative methodology.

And with reference to this IR response is appropriate, could you please take us through the various concerns that the Corporation has with respect to the Board's iterative methodology for target capital purposes, so -- and not for DCAT purposes.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Okay, thank you for letting me have a look at this.

So, the first concern mentioned is just that we -- we would never want to suggest that we should have a lower target below the amount that we feel is necessary for the absolute minimum level needed for satisfactory financial condition. So, we think that's a reasonable position for any reason, like, we would never want that.

The second paragraph...

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: I think if we could scroll down to the answer to the question for the -- for Mr. Johnston's reference. Thank you.

MR. STEVE SCARFONE: Ms. McCandless, just to clarify, are you looking for concerns from the Corporation other than what's already been provided in the answer?

MS. KATHLEEN MCCANDLESS: Well, we would ask that Mr. Johnston illustrate for the Board or -- or elaborate on what's been provided here. So paraphrase and add to it as necessary.

But limited to target capital, not to DCAT.

MR. LUKE JOHNSTON: Yes, that's the -- sorry, it's a long answer here and I'm trying to just go through.

So the second one is that we don't think the target capital methodology should include anything other than a best estimate assumption.

So, the -- the whole issue with capital transfers in the methodology, whether that -- that's seen as a modeling item or not, we're struggling with including that in there. So that -- that's the second one.

On a similar topic, last year's RSR

target methodology was based on a 50-50 interest rate forecast and using the same logic, we -- we want the -- the targets to be set on what we feel are best estimates.

So if we are not comfortable using 50-50, that should be stated in the -- of course by MPI and we should always -- whether we agree or not, MPI should always propose what they believe is the best estimate for the -- for the capital calculation.

(BRIEF PAUSE)

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: Would the Corporation's position on the reasonableness or appropriateness of the iterative methodology shift at all if, Mr. Johnston, you were aware that a fundamentally comparable iterative methodology is used by several property-casualty insurance companies in Canada for determining minimum benchmark capital levels?

MR. LUKE JOHNSTON: More -- more information helps, for sure.

I -- my caution with this and any other topic is a -- a -- to -- if we're really going to look at what other people are doing, then let's look at it all, not just the things that lower the number, for example.

So there may be other things that those companies do that we're nowhere close to doing. So if -- if that's what we're going to talk about, let's open it all up.

MS. KATHLEEN MCCANDLESS: At PUB-MPI 1-17 (c), in its response to this Information Request at page 3, the Corporation states at the third line up from the bottom:

"The inclusion of a capital maintenance provision will significantly lower the RSR capital targets in the Board approved RSR methodology."

Given that the Board approved iterative methodology using a modified base scenario that reflects a steady state Basic capital level, please explain why the Corporation has reached this conclusion?

MR. LUKE JOHNSTON: I -- I think the three (3) reasons that I just went through are the -- are the reasons. If that wasn't clear.

MS. KATHLEEN MCCANDLESS: Kristen,

could we please pill -- pull up PUB-MPI-1-16(b) and at this question on page 1 the Corporation was asked to provide the usual, excuse me, scenario statement exhibits resulting from the Board approved upper threshold iterative methodology relative to the lower threshold for the base scenario, the modified base scenario and the selected adverse scenario.

And that was before and after routine management and regulatory rate change actions. So, for example, excluding such RSR rebuilding fee actions. And the responses are provided in the appendices attached to -- to this IR response.

Now, is the Corporation aware that in its decision on the Basic ta -- cart -- target capital upper threshold in Board Order 130/'17 the Board based its finding on the selected adverse scenario after routine management and regulatory actions?

MR. LUKE JOHNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And so, bearing that in mind, why did the Corporation make this change?

MR. LUKE JOHNSTON: Why does the Corporation? Sorry.

MS. KATHLEEN MCCANDLESS: The Corporation made its determination on the basis before routine management and regulatory actions.

(BRIEF PAUSE)

MR. STEVE SCARFONE: Kristen, could you just scroll up to the question while they're caucusing? Thank you.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: I -- I believe our take on this is that we don't know, like, really what other routine rate actions would be included in this -- in this analysis, other than what's already in there. That's the struggle. So if -- maybe we're missing something, but that's -- that's been our concern.

MS. KATHLEEN MCCANDLESS: Mr. Chair, I think this might be an appropriate time to break. I just need a few moments with the Board advisors and we'll have a couple of questions for Mr. Johnston after the break, if that suits.

THE CHAIRPERSON: That's fine. I have to deal with some administrative matters.

So we'll take 20 -- we'll come back at

10 to 11:00.

MS. KATHLEEN MCCANDLESS: Thank you.

THE CHAIRPERSON: Thank you.

--- Upon recessing at 10:32 a.m.

--- Upon resuming at 10:58 a.m.

MS. KATHLEEN MCCANDLESS: Thank you. I believe we're ready to resume now.

THE CHAIRPERSON: I was just going to say that -- our discussion reminded me of when our son tried to explain the movie The Matrix to me and after ten (10) minutes it didn't work so.

Ms. McCandless...?

MS. KATHLEEN MCCANDLESS: So just some housekeeping. There were some off-line discussions over the break and I understand that there is an undertaking to be put on the record. I believe it's directed mainly to Mr. Giesbrecht.

And so could the Corporation undertake to please provide a table of the continuity of the capital maintenance provision over the forecast period.

MR. MARK GIESBRECHT: If that's helpful then, yes, we could provide that.

MS. KATHLEEN MCCANDLESS: Thank you. And included within that a breakout in PF-1, so pro forma 1, the annual written revenue being forecast to be collected in the net capital maintenance provision?

MR. MARK GIESBRECHT: Yes, we'll take that away.

MS. KATHLEEN MCCANDLESS: Thank you.

--- UNDERTAKING NO. 5: MPI to provide a table of the continuity of the capital maintenance provision over the forecast period. And included within that a breakout in PF-1, so pro forma 1, the annual written revenue being forecast to be collected in the net capital maintenance provision

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: Now, back to the issue of target capital. If we could please pull out PUB-MPI-2-10, question (1) -- pardon me the response at page 2.

So this Information Request response shows the assumed routine management regulatory actions made by the Corporation in its modelling of the Basic target capital upper threshold. And these assumed actions include both rate change actions and RSR rebuilding fee actions, correct?

MR. LUKE JOHNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And is the Corporation aware that in its decision on the Basic target capital upper threshold in Board Order 130-17, the Board based its finding on including only rate change actions?

MR. LUKE JOHNSTON: That -- that would -- that would be my assumption, yes.

MS. KATHLEEN MCCANDLESS: And so, bearing that in mind, why make the change reflected here?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Based on what you've said, it does appear that we've included rebuilding fees in here. So if that needs to be corrected we'll have to do that.

MS. KATHLEEN MCCANDLESS: Provided that that can be corrected in the response to PreAsk 1, that would be sufficient?

MR. LUKE JOHNSTON: We'll undertake to do that.

MS. KATHLEEN MCCANDLESS: Thank you.

--- UNDERTAKING NO. 6: MPI to make the correction re: on the Basic target capital upper threshold in Board Order 130-17, the Board based its finding on including only rate change actions and currently it includes building fees.

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: And just following on some other off-line discussions that, Mr. Johnston, you had with Mr. Pelli Anderson (phonetic) there are some outstanding issues to be discussed with respect to PreAsk 2, further discussions will be had over the next break. And so I may just have one -- one (1) follow-up question with respect to clarifying something on that issue. But with respect to target capital, those are my questions with respect to the scenarios.

Now, I -- I do want to go back to something that, Mr. Giesbrecht, you mentioned this morning with respect to the Q2 financial. So the graphic that was at page 2 of the quarterly financial report and that was the 75 percent to 100 percent for capital adequacy for the minimum capital test for Basic.

I believe that your evidence was that that was the desired state, yes?

MR. MARK GIESBRECHT: Yes, those amounts do not today correlate to a prior PUB Order.

MS. KATHLEEN MCCANDLESS: And what is the dollar value of this desired state?

MR. MARK GIESBRECHT: I would have to take that away and it would depend on the date at which you are requesting that information. It would vary depending on what point in time you do that calculation. So there was no absolute dollar associated with -- with that range.

MS. KATHLEEN MCCANDLESS: So, could you undertake to provide that information with respect to the dollar value associated with the desired state as at the second-quarter?

MR. STEVE SCARFONE: Just to -- to interject, Ms. McCandless, I thought I heard Mr. Giesbrecht said there was no dollar amount associated with that range. So, are you asking now for MPIC to conduct that analysis?

MS. KATHLEEN MCCANDLESS: To convert the MTC ratio depicted here to a dollar value.

MR. MARK GIESBRECHT: It would not be difficult to do that. So we can convert it to a required capital amount, if that's helpful we can do that.

MS. KATHLEEN MCCANDLESS: Thank you. So that -- just to clarify for the record then, that is to undertake to convert the MCT ratio of 75 percent to 100 percent, as depicted on page 2 of MPI Exhibit Number 24 to a dollar value.

MR. STEVE SCARFONE: Yes.

MR. MARK GIESBRECHT: As at August 31st.

MS. KATHLEEN MCCANDLESS: As of August 31st, 2018. Thank you.

MR. STEVE SCARFONE: Thank you.

--- UNDERTAKING NO. 7: MPI to convert the MCT ratio of 75 percent to 100 percent, as depicted on page 2 of MPI Exhibit Number 24 to a dollar value As at August 31st, 2018

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: And so the use of the terminology desired state, what is the difference between that desired state and the applied for proposed target capital levels that we've seen reflected in MPI's presentation?

And just for your reference, those target capital levels would be at slide 29 of MPI Number 21.

MR. MARK GIESBRECHT: So the Corporation continues to be of the belief that we are undercapitalized and we are when comparing to other comparable organizations, you know, vastly undercapitalized in comparison to those companies.

And while we want to continue to work with our regulators and -- and with Intervenors, you know, we have our -- our current framework, and that produced the ask of 34 to 85 percent in the application.

Longer term we do want to continue to look at ways to -- to build our capital to a level more comparable to industry norms.

MS. KATHLEEN MCCANDLESS: Okay, thank you. Those are my questions for the panel.

THE CHAIRPERSON: Thank you. Are we proceeding with Mr. Oakes?

MR. RAYMOND OAKES: That's correct, Mr. Chairman and I'm ready to go at this point.

At the outset I'd like to say to this panel even though you've been called the panel number 2, your first in our estimation, even despite the CMMG's position on the CEMP.

CROSS-EXAMINATION BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: But I'm going to deal first with rates and, Kristen, and if I could ask you to put up RM-13 which is contained in My Learned Friend's of documents to Tab 3.

And we'll talk about the major classification required rate changes as it relates to motorcycles. And I assume that this is Mr. Johnston if nothing but for old time sake, and I'd ask you to look at line item 22, the average -- I'm sorry, number 23, full credibility required rate change for motorcycles. I'm looking at the 1.3 percent.

Do you see that, sir?

MR. LUKE JOHNSTON: I do.

MR. RAYMOND OAKES: And, of course, MPI doesn't use full credibility for motorcyclists given that they're only 17,600 units and it shows at line item 25 the credibility percentage would be 74.6 percent.

Do you see that, sir?

MR. LUKE JOHNSTON: I do.

MR. RAYMOND OAKES: And so with my limited math skills applying that credibility percentage, we would have a required rate of some .96, 98 or 97 percent; just under 1 percent.

Would you confirm that?

MR. LUKE JOHNSTON: Just loosely, we would give that -- about 75 percent of weight to the 1.3 percent and we would give the rest of the weight to the overall rate, which is pretty close to zero. So I would say around .9 to 1 percent would be reasonable.

MR. RAYMOND OAKES: Thank you for that. But then we have another line item and that is the line item number 24, and it's the applied for change 3.4 percent?

MR. LUKE JOHNSTON: I see that.

MR. RAYMOND OAKES: And this isn't an actuarially indicated rate based on the calculations that go before in line items 1 to 22, is it? This is a politically motivated management decision that's being featured there.

Would you agree with that, sir?

MR. LUKE JOHNSTON: Well, I can't agree with all of that. How about we start with the first part and say that -- that your statement that this is not part of the accepted actuarial practice rate calculation for the -- the line numbers above that, that's correct.

The additional amount is the capital maintenance provision that we're proposing.

MR. RAYMOND OAKES: All right. And management could've put any number into that applied for change, is that correct?

MR. LUKE JOHNSTON: I don't think that is correct. So what we've come forward with support for why we should have a net 2.1 percent capital maintenance provision, and that's the basis for that number.

This is a regulatory hearing so any number wouldn't -- wouldn't do. We'd have to support it.

MR. RAYMOND OAKES: But if management in their -- in their wisdom said that Manitoba needs a 5 percent CMMP -- then -- CMP then they could've put that in as the applied for change in that column.

MR. LUKE JOHNSTON: So I think what -- what you're getting at is that there is a accepted actuarial practice calculation that it's gone to this Board many times and that give you the motorcycles the 1.3 percent and now there's this new piece called capital maintenance that's being proposed and that is proposed by the Corporation, it's 2.1. And it just is applied to the rate calculation, you know, on proportional basis and that is a management decision.

MR. RAYMOND OAKES: Just to answer the question. If the Corporation had decided that 5 percent was the right number, they could've put 5 percent in there?

MR. LUKE JOHNSTON: Okay. That -- but if -- if we had -- if that was the calculated capital maintenance provision and subject to every, you know, other management considerations that was the -- the number we thought was appropriate, sure, that could -- that could occur.

MR. RAYMOND OAKES: So just getting

back to what the actuarially indicated rate is, you indicated .9, roughly.

MR. LUKE JOHNSTON: Roughly, yeah.

MR. RAYMOND OAKES: So less than 1 percent. By way of undertaking, can the Corporation indicate what the amount of premium revenue would be raised by virtue of a 9 percent -- or a .9 percent increase to the motorcycle class?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: If you're willing to accept this: 10 percent of the $800 would be 80 -- $80, so I would assume 1 percent would be about 8 to $9. So if you -- if you would be willing to accept, you know, maybe 7 to $9 per -- per units and then we would have to say times the 17,000 motorcycles.

But if I could get my back row to do now and if that's a reasonable estimate, we could give you today.

MR. RAYMOND OAKES: That's fine. I would accept that at this point.

MR. STEVE SCARFONE: Yeah, we're -- we're -- yeah, it's not entirely clear. I believe we're going to provide an answer to Mr. Oakes in -- in short order.

MR. LUKE JOHNSTON: That's correct.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Just moving from that rate and looking at the overall financial picture for the Corporation, of course, the numbers get bandied around quite a bit over the course of the hearing, but just at a very high level, ending 2017/'18, the Corporation was reporting net income of about $91.1 million; is that in the range?

MR. MARK GIESBRECHT: That sounds correct for the total results of the Corporation.

MR. RAYMOND OAKES: Okay. And I'm taking these from the financial statement that was adduced in the application and I believe Kristen has the condensed financial statements handy.

But, again, we're going at a high level -- yes, the annual report at page 29.

MR. LUKE JOHNSTON: Mr. Oakes, can I just jump in quickly.

MR. RAYMOND OAKES: Sure.

MR. LUKE JOHNSTON: Just -- let's just -- to end that last line of questioning, .9 percent would be about $141,000 of additional premiums from motorcycles.

MR. RAYMOND OAKES: Thank you, sir. So the Corporation has approximately $3.4 billion in assets. I think the exact numbers 3,000,480 -- or 3,482,000,857, roughly 3.4 billion?

MR. MARK GIESBRECHT: That's -- that's correct on a total consolidated basis, yes.

MR. RAYMOND OAKES: All right. And then we look at retained earnings and we're showing the growth from the number indicated in retained earnings for 2017 and we're showing 261,532,000 growing to 352,608,000 in 2018.

Is that correct, sir?

MR. MARK GIESBRECHT: That's correct.

MR. RAYMOND OAKES: And then there was Exhibit 24, Kristen, the one you had previously there, the quarterly financial report, and we've seen, again, this continued excellent growth in retained earnings, and we see those retained earnings going from 352,608,000 roughly to 425,464,000,000 as of August 31st, 2018.

Is that correct, sir?

MR. MARK GIESBRECHT: That's correct.

MR. RAYMOND OAKES: And then moving from that we've also heard that in the application that the revenues have increased by over $65 million.

Is that correct?

MR. MARK GIESBRECHT: Sounds about right, yes.

MR. RAYMOND OAKES: And then CMMG-1-12 talked about the decrease of $5 million in the basic operating expenses for the Corporation.

Do you recall, sir?

MR. MARK GIESBRECHT: Yes.

MR. RAYMOND OAKES: And then investment income, some other good news as well, we saw $38.2 million increases in investment income?

MR. MARK GIESBRECHT: If you could point to the reference then I can confirm that.

MR. RAYMOND OAKES: Okay. Would you accept that, subject to check, based on your knowledge?

MR. MARK GIESBRECHT: Yes.

MR. RAYMOND OAKES: Okay. The benchmarking part of the application, page 16, we saw the 2016/'17 net investment yield increase to 6.08 percent?

MR. MARK GIESBRECHT: Yes.

MR. RAYMOND OAKES: And all of this in a climate where we saw overall claims costs decreased by $72.5 million?

MR. MARK GIESBRECHT: Yes.

MR. RAYMOND OAKES: And then going -- sticking with the benchmarking part of the application, the observation at page 12.

MR. MARK GIESBRECHT: Just to back up one (1) second.

MR. RAYMOND OAKES: Sure.

MR. MARK GIESBRECHT: I do want to clarify. When we are looking at the claims costs and how they move, there -- there is an adjustment made to the actuarial reserves based on changes in interest rates and as interest rates move, it can -- there's a revaluation that's done.

And so, looking at the face of the statements if we don't factor in what that adjustment is, it -- it -- it can make it appear as though claims are, you know, dramatically reducing or there's less claims when, in fact, the actual incident of claims is -- is generally remaining similar or even growing as there are more cars and vehicles on the road.

So we do need to factor that in in terms of the actual incidents of claims versus interest rate effects on the valuation of long-term liabilities.

MR. RAYMOND OAKES: Thank you, sir. I do intend, as part of my cross-examination, to talk about the Corporation's conservatism in the selection of interest rates. So we'll perhaps talk about that at that juncture.

The observation at page 12, MPI's gross expenses and percentage of GPW rate has steadily decreased annually?

MR. MARK GIESBRECHT: Yes. We continue to very hard at -- to contain our expenses, and -- and gaining efficiencies.

MR. RAYMOND OAKES: The observation at page 17, MPI's claims experience as a percentage of GPW rate has decreased from 7.2 percent to 5.96 percent?

MR. MARK GIESBRECHT: I see that.

MR. RAYMOND OAKES: Observation at page 18, claims expenses per reported claim has decreased?

MR. MARK GIESBRECHT: I see that.

MR. RAYMOND OAKES: At page 22, there's been a decrease in MPI's staffing?

MR. MARK GIESBRECHT: Yes.

MR. RAYMOND OAKES: And also a decrease in MPI's total gross expenses?

MR. MARK GIESBRECHT: Yes.

MR. RAYMOND OAKES: And then if, Kristen, if I could ask you to bring up CMMG-1-7. And that's figure 2 of that response to that interrogatory.

And -- and notice -- if you look at the loss ratios on the right-hand side, I noticed that the loss ratios seem to continue to decline for both vehicle classes, both motorcycles, and private passengers. Can you respond to that?

MR. LUKE JOHNSTON: I can. Can you just scroll just a little bit higher, so I can see the title?

Okay. One second. Just one moment, please.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: The -- I would -- I would suggest that we can really -- like, these are reported amounts, recognizing that the bigger claims aren't fully lifetime reserved until a couple years after they've been opened, I wouldn't put much weight into the most recent two (2) years, but maybe there's some decline observed in the period of 2007 to 2015, I'll -- I'll give you that, yeah.

MR. RAYMOND OAKES: So I'm asking the Corporation whether it can understand the position of the CMMG that these are very good times for the Corporation, as evidenced by all of the increases in revenues, the retention of those revenues, and the decreases in expenses, both on the overhead and the claims expenses?

Can you understand that the Corporation thinks that this is not time for MPI feathering its nest? It's time, perhaps, to look at returning some of those premiums to its customers.

MR. MARK GIESBRECHT: I think it's important that we look at the -- the short-term history that MPI has gone through. And prior to last fiscal year, we had endured a sustained number of years with significant losses, and -- and we -- we continue to look at long-term assumptions and long-run expectations.

And so, we do not feel it would be in any way prudent to expect that, you know, twelve (12) months, while it is good experience, and we hope it does continue, and we continue to work hard at controlling expenses and paying the appropriate level of claims. However, it is not in our estimation a --

a reasonable or prudent approach to bake in, you know, the last twelve (12) months of favourable experience.

It will continue to roll into our long-term results, and our -- our forecasting. And the intent and the hope -- we -- we certainly hope that this will continue, but, you know, the -- the CMP is an integral part of our plan to manage stable and predictable rates for all Manitobans, which we feel is -- is paramount.

MR. RAYMOND OAKES: The Corporation enjoys a RSR of about 173.5 million, as indicated in PUB-1 point -- 1-16. Is that correct, sir?

MR. MARK GIESBRECHT: Subject to check, I think it might be a different value. If you give us one moment, or -- or if you can point us to that reference.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Well, the oth -- the other reference I had was at was at 2017/'18, the amount was 170 million nine hundred and seventy-five (975), but this morning's testimony talked about a value of 173.5 million.

MR. LUKE JOHNSTON: Mayb -- maybe

could we just pull up the pro forma section? We'll -- we'll just take the actual number off of there for you.

MR. MARK GIESBRECHT: Yeah, like, PF-3 or 4?

MR. LUKE JOHNSTON: Do you have PF-3?

(BRIEF PAUSE)

MR. MARK GIESBRECHT: So you'll see total basic equity in the -- the year ending 27 (sic)/2018 was a total equity balance of two hundred and ten (210) -- eight forty-five (845) which was comprised of retained earnings of 170 million and total AOCI of 39.8 million.

MR. RAYMOND OAKES: And the amount of the RSR?

MR. MARK GIESBRECHT: Two hundred and ten (210) million.

MR. RAYMOND OAKES: All right. So a couple of days ago, in your testimony, you talked about Manitobans in terms of their reserves, living paycheque-to-paycheque.

And my question is: How many people living paycheque to paycheque do you know that have over $200 million in a reserve?

MR. MARK GIESBRECHT: I am not aware of anyone who has $200 million in their reserves. That reference that I made was an analogy to emphasize the importance of having an appropriate level of -- of reserve, or call it a rainy day fund, for example. I do not purport that living paycheque-to-paycheque is an ideal state for individuals.

In the same manner, I do not purport that having an undercapitalized company is a desirable state, and will not enable us to manage rates, to keep them stable and predictable, which will in turn allow folks -- and -- and Manitobans to budget for those premiums.

MR. LUKE JOHNSTON: Just -- if -- if I can add to that, we're an insurance company. And based on the line 25, we had forty-four (44), let's say, dollars in our pocket, if -- if they want to use that, and every other public insurer had a hundred dollars ($100) as their target, at least, and the private insurers would have well over two hundred dollars ($200) in their pocket.

So we're by no means asking for a big number, or -- or currently hold a big number compared to anybody -- any other insurance company that I'm aware.

MR. RAYMOND OAKES: I wonder, Kristen, if you could go to CMMG-1-7. And I'm just going to try and bring this back to the motorcycle experience.

(BRIEF PAUSE)

MR. RAYMOND OAKES: Actually, if you could go to 1-6, and figure 1 there, and -- and I just want to look at the actual loss ratios indicated in this table.

And Mr. Johnston, you'll see that 2009, the actual loss ratios for motorcycles was 66.67 percent?

MR. LUKE JOHNSTON: I do.

MR. RAYMOND OAKES: And then in 2011 to -- and 2012, it ranged from 50 percent, roughly, to 60 percent, roughly, in 2012?

MR. LUKE JOHNSTON: That's correct.

MR. RAYMOND OAKES: And we've spoken about this before. 2014, it was 51.76 percent as a loss ratio?

MR. LUKE JOHNSTON: Yeah. We've -- we've also spoken about that we have to read all the numbers, not just the good ones.

MR. RAYMOND OAKES: Right.

MR. LUKE JOHNSTON: Yeah.

MR. RAYMOND OAKES: But in those years, what would you anticipate would be the reaction of the motorcycle insured, where loss ratios are some 50 percent, or 60 percent, and the Corporation is -- if the Corporation sought to introduce at that time a CMP provision asking for another 2.1 percent in addition to that?

MR. STEVE SCARFONE: Mr. Oakes, I don't think it's fair to put to Mr. Johnston what the reaction of an insured might be to any particular decision made by the Corporation.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: All right. Not to be speculative, then, in situations such as the 50 or 60 percent, could they be characterized as a -- an unfair or inequitable rate that was applied in those years?

MR. LUKE JOHNSTON: No, and I'll explain why. So the -- the loss ratio on -- on this table clearly moves around quite a bit. The approximately 50 plus percent of motorcycle losses are from serious claims.

That said, Mr. Oakes, I would definitely recognize that there has been some better experience for motorcycles, and what happens in the rate-making methodology, as you know, is if -- if motorcycle had better experience, their -- their rate falls.

And if you look at that average rate, in -- on the -- I guess the third column, that would be, that has happened, and so we continue to include good and bad years in the experience, and continue to set rates with the objective that -- that they're break-even.

And of course, CMMG should and can come here and debate whether we've done that forecast correctly, like, for the -- for this policy year and any other policy year. But at least going into the rate-setting process, we are coming forward with the intention that those rates should, on average, be -- be break-even.

MR. RAYMOND OAKES: And you mentioned about the volatility. You can't, with any certainty, tell us in 2019, whether it's going to be a year of actual loss ratios of 50 percent, or 90 percent, can you, sir?

MR. LUKE JOHNSTON: I can -- I cannot.

MR. RAYMOND OAKES: In 2010, MPI -- and this is my words -- found approximately $250 million in its provision for unpaid claims in PIPP. And in 2010/'11, the Public Utility Board ordered two (2) rebates, the first of which being three hundred and twenty-one million six hundred and seventy-eight dollars ($321,000,678).

Do you remember those dark days, sir?

MR. LUKE JOHNSTON: The darkness, not so much, but the -- the approximate amounts and how you described where they -- where they came from, I can confirm that.

MR. RAYMOND OAKES: And so the Corporation has an RSR, and we spoke about it, roughly $200 million. It has claim reserves. It has these unpaid PIPP claim reserves, as one (1) example. It has investment reserves.

How many different types of reserves does the Corporation maintain?

MR. LUKE JOHNSTON: Well, there's different reasons and definitions for reserves, so on -- on the claim side, the reserves are there for known claims and -- and the reliability, and they're not -- by no -- they're by no means considered excess monies. They're -- like we talked on the investment side, those are peoples' claims dollars, and we're going to protect them with -- with safe investments.

Their reserve that we've been talking about in terms of capital maintenance and things like that would be the rate stabilization reserve. That truly is intended to be additional funds to manage volatility, protecting its adverse scenarios, things of that nature. I believe that's what you mean by a reserve. Any other reserve that we have would be for a specific purpose related to, say, liability.

MR. RAYMOND OAKES: I wonder, sir, if by way of undertaking, you could indicate how many types of reserves the Corporation maintains.

MR. STEVE SCARFONE: Just for clarification, Mr. Oakes, are you talking about claims reserves or capital reserves?

MR. RAYMOND OAKES: All of them.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: We -- I'm trying to think about this request, but we'll do our best to perhaps label, you know, looking at -- say the balance sheet, and what these amounts are for, and whether they can be called reserves, and then the purpose of the. We can try to -- to do that for you.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Thank you, sir. A provision for adverse deviation -- okay.

MR. LUKE JOHNSTON: I'll take a shot at it, and maybe don't write down until Mr. Oakes agrees with it. We will look at the items on the balance sheet, and -- and so as an example, the claims reserves, we will go through and explain what reserves we have, and what purpose they're for, and the amount.

MR. RAYMOND OAKES: I accept that.

--- UNDERTAKING NO. 8: MPI to provide information on what claims reserves they have and what each purpose and amount is

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: With respect to an item called provision for adverse deviation, or as the Corporation calls them, PFADs, are they different than the types of reserves that would be enumerated in that undertaking?

MR. LUKE JOHNSTON: Those provisions

would be part -- within the claims liability reserve, so those can -- those can be separated out as part of the understanding of the -- so there's about 1.8 billion in liabilities. A portion of that is -- is for provisions for adverse deviation. So we can split those out for you as well.

MR. RAYMOND OAKES: But there's a number of PFADs that the Corporation uses, for instance, PFADs on its receivables, and how collectible they are. Is that correct?

MR. MARK GIESBRECHT: I wouldn't call them PFADs, but there are allowances against those kinds of assets, yes.

MR. RAYMOND OAKES: If we could also -- no, I think that's fine.

With respect to what we heard pre -- in previous years' applications, the Corporation came forward and claimed that it required an interest rate forecast risk. Do you recall that?

MR. LUKE JOHNSTON: Yes, I do.

MR. RAYMOND OAKES: And that was a sum to be collected that is an adjustment going forward.

Do you recall in -- I believe that was in last year's GRA?

MR. STEVE SCARFONE: I believe that

was two (2) years ago, Mr. Oakes, not last year.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: All right. Thank you for that correction. And the Corporation has explained in its testimony that as a result of ALM, and some other changes to the methodology employed by the Corporation, that it no longer needs this interest rate forecast risk collection. Is that accurate?

MR. LUKE JOHNSTON: Yeah. That would be inappropriate for us to ask for now, because we are basically asking for flat interest rates. We're not -- we're not bearing the risk of a -- what I would call a fairly optimistic bank forecast.

MR. RAYMOND OAKES: Okay. And do you recall roughly what the Corporation was looking to add to its collection from consumers for the IRFR?

MR. LUKE JOHNSTON: Off the top my head, I don't, but I can talk to the back row, if you like, if -- or if you have it there.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: We're looking that up right now.

MR. RAYMOND OAKES: Yeah. All right. So now we have a new collection, the Capital Maintenance Provision.

Would you confirm the Corporation hasn't yet completed its Capital Management Plan?

MR. LUKE JOHNSTON: Confirmed.

MR. RAYMOND OAKES: And the effect of the Capital Maintenance Provision is going to be that the Corporation is looking for revenue from consumers of approximately 18 to $20 million. Is that correct?

MR. LUKE JOHNSTON: In -- in -- that's in the ballpark, yes.

MR. RAYMOND OAKES: Okay. And if interest rates rise, there will be, in addition to that 18 to $20 million, additional premium revenue collected from customers as a result of those increase -- interest rate rises after the time of this application and during the applied-for year?

MR. LUKE JOHNSTON: It wouldn't -- we wouldn't get additional premium revenue, but there are other items in terms of our costs that could -- or investment income that would change as a result of improved interest rates on -- on the net basis, it would be favourable to us. It depends on the size of the change how favourable we're talking.

MR. RAYMOND OAKES: Okay. And the Corporation doesn't use the rate established by the Bank of Canada, it uses the 10-year Government of Canada bond rate, isn't that correct?

MR. GLENN BUNSTON: Our goal is to try to forecast the yield on our investment portfolio, specifically our fixed income portfolio. And so we use the yield on the Government of Canada 10-year bond as a proxy and we had to spread to that to forecast the yield on our bond portfolio.

So we don't rely on the overnight rate from the Bank of Canada, no.

MR. RAYMOND OAKES: And what increases in the Government of Canada rate has the Corporation seen this year?

MR. GLENN BUNSTON: I believe the Bank of Canada has increased interest rates twice by 25 basis points each time, so far.

MR. RAYMOND OAKES: And is the Corporation aware of any pronouncement to increase that again this year?

MR. GLENN BUNSTON: Well, I don't think the Bank of Canada signals its intentions in advance of the -- the meeting dates.

I understand that market participants

do expect future increases from the Bank of Canada, potentially this year and in to 2019 though.

MR. RAYMOND OAKES: I guess they must be different than the Fed, which signalled in the States that interest rates would be increasing. They did that about ten (10) days ago, I think.

MR. GLENN BUNSTON: Well, I think both central banks have indicated they expect their administered overnight rates to increase gradually, but they -- they don't give specific dates and amounts in advance, no.

MR. RAYMOND OAKES: I wonder if the Corporation, just by way of undertaking, could indicate what the required premium for motorcycles would be given two (2) more 25 percent basis rate increases in that -- in that rate?

MR. GLENN BUNSTON: Well, there has been a lot of discussion on interest rate forecasting in -- in some of the Information Requests and I think that we've -- we've shown that there is not a direct correlation between the overnight rate and long-term rates, particularly in the short-term.

And so I think it would be difficult to make an assumption on that basis that if the Bank of Canada increased the overnight rate by 25 basis points that that would immediately translate into a similar increase in the 10-year yield.

MR. RAYMOND OAKES: All right.

MR. LUKE JOHNSTON: Mr. Oakes, sorry to interrupt you. So the -- I believe the PreAsk will update the motorcycle rates and everyone else's based on what we have right now.

It is difficult to speculate how our discount rate will react to additional bank overnight rate changes, but at least you'll have some information with the PreAsk.

MR. RAYMOND OAKES: I accept that. You've talked in these hearings over the past couple of days of how MPI could provide additional calculations to this Board and adjustments in its rate application, should the interest rate go up.

Do you recall those discussions?

MR. LUKE JOHNSTON: I do.

MR. RAYMOND OAKES: So, how would that work if the interest rate goes up prior to the Board concluding its deliberations then presumably then the -- the Board Order could reflect that. But what happens to an increase in interest rates or Government of Canada 10-year bond rates that occur after that drop-dead date?

MR. LUKE JOHNSTON: Well, obviously a -- that is for the Board to decide. Like, we can make recommendations, but that's for the Board to decide.

What we -- what -- like, from our perspective what we would hope is that the application, in its entirety, with the exception of the -- you know, say the Government of Canada 10-year bond rate or the current interest rates kind of -- has been fully reviewed and still stands and that one (1) piece of the calculation can be updated as similar to how we're talking about updating it right now.

But that was kind of the idea behind the compliance filing last year. But of course, all parties had to be comfortable doing that.

We've -- we've tried to make it as clear as possible that we are quite happy to have the latest and most updated rates because, as you've heard, we are really -- you know, the tolerance for financial volatility is very low.

So a better rate, a more accurate interest rate as late as possible is good -- is good for us, it's good for ratepayers and I think the PUB would say it's good that -- if we set rates based on the best information.

MR. MARK GIESBRECHT: And just adding

to that, you know, the application, the process that we -- that we go through is -- it's at a point in time and we use the best information available to us at that point in time.

After the Order is -- is issued, there could be changes in claims experience, market factors, including interest rates. So, all those things would then be factored into a subsequent GRA process.

MR. RAYMOND OAKES: Just to bring those answers bra -- back to brass tacks, if I can, or exact examples, let's say that those rates are increased significantly, a basis -- 25 basis points or more on December 31.

The result would be that the Corporation would retain additional profit from selling its insurance in 2019, isn't that correct?

MR. LUKE JOHNSTON: Yes, and -- and -- the reason, as we've talked about, that we're -- we're at where we are today, is that the -- the assumption that these bank forecasts are -- are correct has turned out really horribly wrong. I don't know how else to describe that.

So we are, clearly, trying to find ways here to find a happy medium where all parties can be comfortable with what's going forward. We're clearly not comfortable with really aggressive optimism in the interest rates, but we're definitely comfortable with updating the rates as late as possible to -- if we can, you know, somehow find a middle ground here.

MR. RAYMOND OAKES: Would you agree with me, sir, that this $18 to $20 million of the Corporation's hoping to raise called the CMM -- CMP is very handy for the Corporation's executive because once it's ordered to be paid, the Corporation can use it to offset unanticipated expenses, cost overruns, errors in program design or management, or any other problematic issue without having to come back to this Board for funds to address those problems?

MR. MARK GIESBRECHT: The CMP is -- is meant to be able to absorb events that are not -- are outside the norm, the -- the -- you know, the extreme weather events, the large hail events, all those kind of things which could include, you know, market changes, downgrades in market assumptions and equity returns and all these kinds of things.

It -- you know, it could absorb other things, a cost overrun potentially. We are working very diligently on our expenses, and -- and we have shown and you walked us through it earlier, how our costs have been coming down and we continue to work on ensuring that we are having efficient operations.

And so the CMP, the purpose of it, is to be able to offer to Manitobans the ability to offer stable and predictable rates. That's part of our management, it's really -- it's core to our mandate and that is why we are requesting a CMP be introduced into our methodology.

MR. RAYMOND OAKES: I would ask you, sir, to respond to the assertion that this capital is not to protect the Manitoban, the insured from adverse events, but more to protect the Corporation from its own missteps potentially going forward, whether -- and the Corporation has spoken about how it can be wrong on a number of issues. That that's really what this comes down to, it protects the -- the Corporation from adverse events instead of its consumers.

MR. MARK GIESBRECHT: I would not agree with that, in terms of the -- the Corporation is Manitobans. So what we do with the Corporation, how we manage the funds, how we manage our rates ultimately will affect all Manitobans. And so we -- we work at these processes and this methodology with the intent to be able to appropriately manage and share the risks of the road and ensure that we are delivering value to Manitobans and ensuring that we can maintain predictable and stable rates.

And so it is not to absolve management of poor -- poor choices or mistakes. That said, we are not perfect, we will make mistakes from time to time and we -- you know, we will learn from those things.

And we have seen examples in the past where we've had strategies or plans that maybe didn't work out as well as we would have hoped. However, the -- the intent of a CMP is by no means to take away the accountability or the responsibility of management. It is to manage appropriately as an insurance fund using best practice and ensure that we have the ability to manage capital to deliver on our mandate to Manitobans.

MR. RAYMOND OAKES: Thank you for the answer. I have some questions back to the RSR. Kristen, if I could ask you to bring up CMMG-1-11, Appendix 1.

And we're going to look right to the right-hand column, the PUB approved RSR range. And you'll see that before 2005/2006 the PUB approved range was 50 million to 80 million.

MR. LUKE JOHNSTON: Yes.

MR. RAYMOND OAKES: And during those

years before 2005/2006, the Corporation still carried out its mandate to provide insurance to Manitobans?

MR. LUKE JOHNSTON: That we did.

MR. RAYMOND OAKES: 2006 and '07 and 2007 and '08, the PUB approved range was 69 million to 105 million. Is that correct?

MR. LUKE JOHNSTON: That's correct.

MR. RAYMOND OAKES: And the Corporation still carried out its mandate to provide insurance to Manitobans?

MR. LUKE JOHNSTON: Yes.

MR. RAYMOND OAKES: 2008 to 2009, the range was 72 million 109 million.

MR. LUKE JOHNSTON: Yes. Sorry. Yes.

MR. RAYMOND OAKES: 2015/'16, saw that jump to 231 million to 366 million, is that correct?

MR. LUKE JOHNSTON: That's correct.

MR. RAYMOND OAKES: Was the provision of insurance in 2015/'16, very different than the provision of insurance in 2014 and prior?

MR. LUKE JOHNSTON: The insurance itself was not, the corporate risk profile was probably a little bit bigger than it was just from the growth in the business, but otherwise somewhat similar between the years.

MR. RAYMOND OAKES: When you say that, can you quantify that for me. The increase in the business generated, you know, what percentage changed in the Corporation's risk?

MR. LUKE JOHNSTON: Well the -- the issue here we have, I guess, is that you're going on the assumption that the, you know, 50 to 80 million was -- was it the right number or whatever that means, right.

So the -- the push in the last, you know, five (5) to ten (10) years has been to make the -- the -- the range based on the risks of MPI, that MPI has, and quantify that. So that led to some of these -- you can see it through the ranges at the end that we're -- we're working on that, coming to a consensus on that.

But the old years were basically -- most of those old years were a percentage of premium, so just taking 10 to 20 percent of the current premiums and using that as a range. But that really didn't reflect the risks in our -- that we had on the balance sheet. So we've been working to create new ranges that reflect that.

MR. RAYMOND OAKES: Okay, but I'd still like an answer to my question.

You indicated that there was a change to the Corporation in its risk profile and you indicated that -- and that was, I believe, as a result of growth in the units.

What are we talking about in terms of percentage?

MR. LUKE JOHNSTON: That's -- I would have to -- I would have to have a closer look, Mr. Oakes, but the -- the liabilities and growth, I would proxy probably around the 4 to 5 percent range and then the assets would -- would grow with it.

I would have to check for a more detailed number, but would -- it wouldn't be 10 percent, for example, and it wouldn't be 1 percent. I would peg it around 4 to 5 percent.

MR. RAYMOND OAKES: All right.

Well, certainly the range in the RSR didn't go up by 4 percent, it roughly doubled.

MR. LUKE JOHNSTON: Yeah, that -- I -- I can't remember everything about those years, but that was likely from a proposed methodology change to how to calculate that range.

So 366, my recollection was that that was 100 percent MCT target, which that was not ordered the year before.

MR. RAYMOND OAKES: Right. But even that 231 million minimum, that's an outlier in fourteen (14) of the fifteen (15) years that are shown there, isn't that correct?

MR. LUKE JOHNSTON: I agree, that's a -- that would reflect a methodology change.

So that -- the instability that you see is from methodology changes, not so much from changes in risk profile. So, this asset liability study is an example of a significant change in risk profile. But for most of this history there haven't been, like, really significant changes in risk profile.

So, you're correct in that our range has had some volatility when we've tried to change methodologies.

MR. RAYMOND OAKES: Would you agree with me, sir, during these fifteen (15) years there were not significant draw-downs on the RSR as a result of insurance issues?

MR. LUKE JOHNSTON: I -- I can agree to that. I think column C would -- would show you that there is quite a few transfers made from other lines to -- to prop up the Basic RSR, and then from 2012/'13 through 2016/'17, those are some rough years for Basic in terms of net losses, 63 million, 69 million, a breakeven year basically and then a loss of 56 million and a loss of 123 million.

So that -- that is very troubling when we're talking about RSR targets and the, you know, like our current RSR target, for example, a minimum is in the $120 to $140 million range, we've probably lost double that just in that period.

MR. RAYMOND OAKES: And none of those reflected one-time insurance risks that materialized and caused the Corporation to draw-down on the RSR?

MR. LUKE JOHNSTON: One (1) time extreme events would -- I would say no, if we're, say, talking 1:100. But as I mentioned in our presentation, what we found through a lot of the modelling is that combinations of events tend to be where we get hit the hardest.

So, it doesn't have to be a 30 percent decline in the stock market, but you know, a slight decline, some bad weather, movements on interest rates, a combination of things, a lot of this reflects interest rate changes of these losses.

But combine some interest rate declines with a bad winter, for example, and all of a sudden you've lost, you know, 60 plus million.

MR. RAYMOND OAKES: Now, I don't have

the reference for you, but I'm sure the number is familiar to you. MPI forecasts that as of February 28, 2020 it will have 280 million in the RSR.

Can you confirm that?

MR. LUKE JOHNSTON: If we bring up pro forma 3, that would give us what we need.

I believe you said at the end of '19/'20, so 280 million?

MR. RAYMOND OAKES: Right.

MR. LUKE JOHNSTON: Agree.

MR. RAYMOND OAKES: Thank you. And then the court -- the question I have is: If the Corporation does an excellent job of matching assets and liabilities, deciding well on its investment selection and has good investment performance and claims do not develop worse than predicted, then there would be additions to the RSR from the bottom line of the Corporation.

Can you confirm that?

MR. LUKE JOHNSTON: We -- so what -- I can't remember everything that you described, but if we do everything right as forecasted, traditionally we would make no money.

So -- and then if anything goes wrong, we would lose and -- and, right, and sometimes things go well and we make money.

There is no buffer there for -- for error, and we get that, it's the public insurance program. And the -- all this forecast is saying is that with the inclusion of the capital maintenance we'll keep that buffer at a proportionately fair -- or sorry, not fair, but proportionately equal level at 70 percent MCT. That's all that's saying.

MR. RAYMOND OAKES: There's a number of years in which liabilities haven't outpaced growth in the RSR.

MR. LUKE JOHNSTON: I think you're meaning that there's -- there's been good years where we've -- is that fair, that we've had positive results and it's been more than we forecasted, if that's what you mean then for sure that's happened, yes.

MR. RAYMOND OAKES: All right.

Mr. Chairman, I was looking at taking us to the lunch hour and we're very close, I'll just ask a few more questions and then I think we have the morning.

THE CHAIRPERSON: Certainly. Thank you.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: The question I have is on road safety, recognizing that's the subject of the technical conference to come, but the list of issues talked about the amount of investment by the Corporation in road safety, asked the Corporation to confirm that it's still only $227,000 spent on motorcycle-specific initiatives in Basic.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Sorry, Mr. Oakes. So this panel, we don't have that at our fingertips. But I'll let Mr. Scarfone...

MR. STEVE SCARFONE: Yes, so Mr. Oakes, on the road safety questions, particularly the expenses, we could either defer that to -- to when our controller is available to answer questions on expenses, or the alternative would be to -- just to provide you with an undertaking at this point on that. Whatever you prefer.

MR. RAYMOND OAKES: I'll take the undertaking. We can adjourn for lunch.

MR. STEVE SCARFONE: Very good. So the undertaking then, just -- can you repeat it for the record? I'm sure you're going to be asked.

MR. RAYMOND OAKES: I'm looking for the Corporation to confirm that the amount spent on motorcycle-specific road safety initiatives in the coming GR -- in the coming application is still only the budgeted amount of 227,000 for Basic's share.

MR. STEVE SCARFONE: Very good. Thank you.

MR. RAYMOND OAKES: Thank you.

--- UNDERTAKING NO. 9: MPI to confirm that the amount spent on motorcycle-specific road safety initiatives in the coming application is still only the budgeted amount of 227,000 for Basic's share.

THE CHAIRPERSON: Thank you.

We will adjourn until one o'clock.

--- Upon recessing at 12:00 p.m.

--- Upon resuming at 1:08 p.m.

THE CHAIRPERSON: Good afternoon.

We're going to resume now. We're going to deal with Mr. Makarchuk so that he get out -- get out of here early. So my understanding is Mr. Oakes has a question for him. And then, Mr. Williams has some questions and at that point you can be excused and we'll continue with Mr. Williams' cross-examination of the panel. I believe that's -- that's the way we're proceeding? Okay. Mr. Oakes...?

MR. RAYMOND OAKES: Thank you, Mr. Chairman.

CONTINUED BY MR. RAYMOND OAKES:

MR. RAYMOND OAKES: Mr. Makarchuk -- Makarchuk?

MR. DAVID MAKARCHUK: Manitoba is Makarchuk. Everywhere else is Makarchuk.

MR. RAYMOND OAKES: All right, thank you, sir. Kristen has put up for us page 15 of your report, which is Exhibit 23, and I want to refer you to that middle paragraph, it says:

"While we acknowledge the Canadian inflation rates have increased significantly since the beginning of the study, 2.8 percent at August 2018 versus 1.4 percent August

2017."

Do you see that, sir?

MR. DAVID MAKARCHUK: I do.

MR. RAYMOND OAKES: And my question is the effect of -- the likely effect of those inflation rates on interest rates.

With your background, can you comment on the fact that these are often a precursor to increased interest rates and the environment?

MR. DAVID MAKARCHUK: There certainly is some correlation between where short-term inflation is and short-term interest rates. Short of inflation to long-term in interest rates, for example, the yield curve certainly has not increased by 1.4 percent over the last twelve (12) month period.

MR. RAYMOND OAKES: And can you just confirm what you would anticipate seeing in the coming year relative to this doubling of the inflation rates that you refer to?

MR. DAVID MAKARCHUK: Our anticipation for inflation?

MR. RAYMOND OAKES: For interest rates.

MR. DAVID MAKARCHUK: For interest rates. Short interest rates or long interest rates?

MR. RAYMOND OAKES: Short.

MR. DAVID MAKARCHUK: Sure. So short interest rates don't have a lot of importance in the context of the asset liability study. They do have a little bit to the extent that MPI has short-term obligations. Short interest rates have definitely gone up. They haven't even gone up 1.4 percent either.

In terms of where they go from here? The market generally prices in a lot of future expectations. I have no -- I'm trying to think about our Mercer perspective. We probably expect a bit more of an increase in the yield curve, probably fairly parallel. It's plausible it flattens. But much of the increase that we've already seen is likely higher than what we will see going forward over the next year or so. If that was your question.

MR. RAYMOND OAKES: When you say "likely higher," are you talking again about inflation rates though?

MR. DAVID MAKARCHUK: No, I was thinking more of interest rates in answering your question. If anything, I expect inflation to find its way back down to the 2 percent level over the next twelve (12) months or so.

MR. RAYMOND OAKES: Thank you for that.

THE CHAIRPERSON: Mr. Williams...?

DR. BYRON WILLIAMS: Yes. And good afternoon, members of the panel.

Just in terms of one (1) preliminary matter, there was a couple questions that may have required us to go in camera with regard to confidential material. In conversations with My Learned Friend's legal counsel for Manitoba Public Insurance, what we're proposing is that we -- we present what would likely have been an undertaking in any event to Manitoba Public Insurance in writing restricting the -- the request only to those who have agreed to the confidential information.

They'll make a determination whether they can accept that undertaking and -- and we'll proceed by there rather than having to -- to go in camera for a couple minutes, if that is satisfactory with the Board? And I believe that's consistent with my conversation with Manitoba Public Insurance.

MR. STEVE SCARFONE: Yes, that's correct, Mr. Chairperson. We have no objection to proceeding in that manner if the Board sees fit.

THE CHAIRPERSON: Yes, we can proceed

in that direction. If we need to go into in camera, there's a process that we need to follow that will take about five (5) minutes I understand from the court reporter to set up. We need to create a tape and transcript and that so.

Let's -- let's see if we can proceed in this manner.

CROSS-EXAMINATION BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Thank you. And I can indicate that the -- the area of inquiry that I'll be starting with relates to asset liability issues. Most of my questions will be for Mr. Makarchuk, but some also will go to other members of the MPI panel. They're interrelated so.

And with that being said, Mr. Bunston I wonder if I could ask Kristen to pull up MPI Exhibit 13-3, being the supplemental affidavit of Mr. Bunston sworn September the 7th, 2018.

Do you have that before you, Mr. Bunston?

MR. GLENN BUNSTON: Yes, I do.

DR. BYRON WILLIAMS: And, sir, this was an -- just to backup for a second, you'll agree that in response or in part of a response to a motion to compel certain Information Requests of CAC (Manitoba), you swore an affidavit on August 20th, 2018?

MR. GLENN BUNSTON: Yes, that's right.

DR. BYRON WILLIAMS: And in this document, being Exhibit MPI-13-3 dated September 7th, 2018 you amended that affidavit to eliminate certain errors relating to the spectrum of risk and return for the real liability benchmark; agreed?

MR. GLENN BUNSTON: Yes, that's right.

DR. BYRON WILLIAMS: And directing your attention to paragraph 3, sir, of that affidavit. Starting out in terms of the real liability portfolio, you indicate that initially you had indicated that its projected return was 1.9 percent, correct?

MR. GLENN BUNSTON: That's correct.

DR. BYRON WILLIAMS: Just before Mr. Bunston continues, and My Learned Friend, I'm sorry to interrupt you at this early stage, we may need some direction from the Board on this particular area of cross-examination.

And the reason I say that, Mr. Chairperson, is for this reason: There was, as you know, a motion that was brought and decided upon by the Board. No cross-examinations occurred on the affidavits. There have been -- there's been further evidence produced as a result of that motion.

Certainly, it would be fair for My Learned Friend to cross-examine on the additional material that was produced by Mercer as a result of the motion, but I don't believe that would extend to a cross-examination on an affidavit for a motion that's already been decided.

DR. BYRON WILLIAMS: Mr. Chair, on behalf of our client, we would submit that this is relevant and necessary information and we'll start with this.

If you think of the case theory of Manitoba Public Insurance loudly proclaimed on -- on -- on Monday, it was that the nominal liability benchmarking and ultimate portfolio represented lower risk. And a central element in this hearing is whether Manitoba Public Insurance has misaligned and miss -- failed to account for a significant source of risk being real interest risk.

This information is -- is relevant to that dialogue as it goes to the actual -- and it also goes to the methodology which Manitoba Public Insurance adopted in rejecting the real liability benchmark approach at a very -- a relatively early stage in its analysis.

THE CHAIRPERSON: We'll allow the questioning.

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Mr. Bunston, directing your attention back to paragraph 3. In terms of the real liability benchmark, you had initially indicated it's -- it had a lower return of 1.9 percent; agreed?

MR. GLENN BUNSTON: That's correct.

DR. BYRON WILLIAMS: You amended that to show a return of 2.4 percent and that was in response to changed assumptions in terms of interest rates; agreed?

MR. GLENN BUNSTON: If I recall that was because we did analysis based on both Mercer standard interest rate forecast and the int --

DR. BYRON WILLIAMS: The forward.

MR. GLENN BUNSTON: -- interest rates based on the forward curve.

DR. BYRON WILLIAMS: Yes. So you're agreeing with me, sir?

MR. GLENN BUNSTON: Right. So this information that -- the 2.4 percent return is based on the forward curve outlook.

DR. BYRON WILLIAMS: Thank you. And, sir, in your initial affidavit you had suggested that the ra -- rejected portfolio really being the real liability benchmark had a much higher risk of 3 perfect; agreed?

MR. GLENN BUNSTON: Agreed.

DR. BYRON WILLIAMS: And you subsequently amended that assessment to suggest that the real liability benchmark showed a risk of 0 percent; agreed?

MR. GLENN BUNSTON: Correct.

DR. BYRON WILLIAMS: And, sir, with that amended information when you compared the -- in this affidavit being paragraph 3, the estimated risk of the real liability benchmark of 0 percent as against the risk of the nominal portfolio selected of 1.32 percent, you concluded that the risk related to the real liability benchmark was lower?

MR. GLENN BUNSTON: It is lower, yes.

DR. BYRON WILLIAMS: Sir, just directing your attention to paragraph 5 for a second. Here again, sir, you're clarifying and correcting your suggestion that the MPI selected portfolio had lower risk when it -- what you're suggesting here, in fact,

it had higher risk?
MR. GLENN BUNSTON: That's correct.
DR. BYRON WILLIAMS: Okay. And the last point, sir -- and we'll get into minimum risk portfolios and liability benchmarks a bit later but in this analysis, when you're comparing, what you were doing was comparing a liability benchmark related to real liabilities versus the actual selected portfolio; agreed?
MR. GLENN BUNSTON: Yes, that's correct.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Mr. Makarchuk, I can indicate that I did follow the discussion yesterday and that to the extent that I trespass upon questions previously asked by Board counsel, it's for a different purpose, just so...
But in terms of real return bonds, sir, would it be fair to say, sir, that they have the components of a conventional bond be, namely, coupon payments and ret -- return of principal at maturity?
MR. DAVID MAKARCHUK: That's correct.
DR. BYRON WILLIAMS: And of course,

one (1) of the distinguishing features of real return bonds is that the return of principal at maturity is linked to the Consumer Price Index over the respective term; agreed?

MR. DAVID MAKARCHUK: Both the coupons along the way and the principal at the end are related to the increase in CPI along the way.

DR. BYRON WILLIAMS: And I was going to get there but you short-circuited the question so thank you.

In essence, what you're saying is that the coupon payments and adjusted principal repayment are dependent upon future inflation?

MR. DAVID MAKARCHUK: Absolutely.

DR. BYRON WILLIAMS: And so if I were to define the real yield as being the yield in excess of the Consumer Price Index, the real yield for real return bonds is known at the date of issue; correct?

MR. DAVID MAKARCHUK: Date of issue, and then the date of purchase if you're buying it mid way.

DR. BYRON WILLIAMS: Okay, thank you, fair enough. And by that way, real return bonds serve as a explicit hedge against inflation risk; agreed?

MR. DAVID MAKARCHUK: Yes, if an

investor wants to guarantee a real return then -- and a real return bond is an excellent way to ensure that they get that real return, that after inflation return.

DR. BYRON WILLIAMS: Thank you. I wonder if I can ask Ms. Schubert, Kristen, to turn to Part 6, Appendix 17, Attachment (a), Page 1753, just for a moment. Page 17. So this would to be slide 1 of this attachment for a second, Kristen. Slide 1. Thank you.

And Mr. Makarchuk, we're just going to this slide just to have you confirm that this was a -- a discussion paper or PowerPoint shared with Mercers -- with Manitoba Public Insurance on or about November 8th, 2017 --

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: -- agreed?

MR. DAVID MAKARCHUK: Yep.

DR. BYRON WILLIAMS: And it was for the purpose of a discussion to -- to -- to pursue the ongoing discussion related to asset liability matching; agreed?

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: And now, Kristen, if you wouldn't mind turning to Slide 21.

Mr. Makarchuk, I'll suggest to you that on this slide being Slide 21 of Appendix 17, Attachment (a), you're trying to provide some insight into the inflation protection of real return bonds by doing a breakeven inflation rate analysis; would that be fair, sir?

MR. DAVID MAKARCHUK: Yeah, there's a few things going on on this page, but that's one (1) of them.

DR. BYRON WILLIAMS: Okay. And the breakeven inflation rate is calculated as the difference between a conventional bond and a real return bond; agreed, sir?

MR. DAVID MAKARCHUK: Essentially, yes.

DR. BYRON WILLIAMS: And it's intended to capture the capital market's expectations as to future inflation; would that be fair, sir?

MR. DAVID MAKARCHUK: That's definitely one (1) way to interpret -- that's the way we'd interpret it, sure.

DR. BYRON WILLIAMS: And if I were to look at this calculation on page 20 -- 21. Well, let me back up. When we use the term "breakeven inflation rate," is it intended to suggest that you would receive roughly the same total return on a real return bond as you would on a 30-year Long Canada bond if inflation averages the level of 1.6 percent over the next ten (10) years?

Is that what that -- that table is showing us?

MR. DAVID MAKARCHUK: Essentially, yes, and say -- we talked about this a bit yesterday because otherwise arbitrage opportunities, if the fair -- or the market price of a similar duration nominal Canadian bonds, say, a 30 year bond that has a price, there's also a market price of a real return bond. Let's say it's 30 years of duration as well.

We know, clearly, what the yield is on the regular bond. In this case, it was 2.3-ish percent. And we know that the yield when we look at the price of the real return model was at 2.2-ish percent. And so we also know that the real return bond has a real return of .6 percent. So that implies that the market is forecasting long term inflation to be 1.6 percent.

If the market was otherwise expecting inflation to be significantly higher or lower, then the price of the real return bonds would be lower or higher -- I'm pretty sure it flips -- to make sure that there is equivalence.

Does that answer your question?

DR. BYRON WILLIAMS: That answered the question very well, sir. We may come back to this page.

And I know you did have a discussion about nominal and real interest rate again yesterday. But if my -- if I or my client expected inflation to be 2 percent and I needed to maintain purchasing power and earn a 1 percent real rate of return, the -- what I would -- return I would require from my nominal bond would be 3 percent.

Agreed, sir?

MR. DAVID MAKARCHUK: If you wanted 1 percent real, and you expected 2 percent inflation, you would need a yield of 3 percent. Yeah, that's correct.

DR. BYRON WILLIAMS: And of course, in simplistic terms, the real interest rate plus expected inflation allowed us to -- to calculate the nominal interest rate, or could allow us to calculate the nominal interest rate, agreed?

MR. DAVID MAKARCHUK: The yield.

DR. BYRON WILLIAMS: Yes, thank you. So let's say that if I earned 3 percent nominal, and after I take -- I take away the 2 percent inflation, I have 1 percent real purchasing power, agreed?

MR. DAVID MAKARCHUK: Yes. If inflation turns out to be 2 percent, and you'd otherwise have 1 percent purchasing power. Correct.

DR. BYRON WILLIAMS: And if inflation exceeds that 2 percent, its expected assumption -- of course, I'll realize that after the fact -- then I'll lose relative purchasing power, agreed?

MR. DAVID MAKARCHUK: If you held the bond to maturity, sure.

DR. BYRON WILLIAMS: At a high level, sir, you're familiar with the -- the concept of the Fisher effect?

MR. DAVID MAKARCHUK: At a high level.

DR. BYRON WILLIAMS: And I'll suggest to you, sir, it's an economic theory that attempts to describe the relationship between inflation and both real and nominal interest rates, agreed?

MR. DAVID MAKARCHUK: Yeah.

DR. BYRON WILLIAMS: And in essence, it states that the real interest rate equals the nominal interest rate minus expected inflation?

MR. DAVID MAKARCHUK: That's my understanding.

DR. BYRON WILLIAMS: And in all that calculation, we're allowing for comp -- compounding as well, agreed?

MR. DAVID MAKARCHUK: Sure. Yeah.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: And based upon the Fisher effect theory, it would be fair to say that real interest rates fall as inflation increases, unless nominal rates increase at the same rate as inflation, agreed?

MR. DAVID MAKARCHUK: I prefer to use the term real returns fall --

DR. BYRON WILLIAMS: I'll except that, sir.

MR. DAVID MAKARCHUK: -- as opposed to rates, but I'd otherwise agree.

DR. BYRON WILLIAMS: So if I substitute and suggest you that real interest returns fall as inflation increases unless nominal returns increase at the same rate as inflation. You'll accept that, sir?

MR. DAVID MAKARCHUK: Sure. Yeah.

DR. BYRON WILLIAMS: I want to use one

(1) further example, this time in a loan context, sir, perhaps at the risk of belabouring the Fisher effect to death.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Sir, if -- taking a loan example, if the loan has a 7 percent interest rate, and the inflation rate is 2 percent, then the real return on that loan would be 5 percent, sir?

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: And you'll agree as well, sir, that at the time the loan agreement is made, the inflation rate that will occur in the future is not known with certainty, correct?

MR. DAVID MAKARCHUK: Any time you make a future investment, you don't know. Correct.

DR. BYRON WILLIAMS: So in this case, the borrower and the lender are using their expectations of future inflation to determine the interest rate on the loan, agreed?

MR. DAVID MAKARCHUK: There's probably multiple factors that go into the determination of the interest rate in loan -- or on the loan. That could be one (1) of them.

DR. BYRON WILLIAMS: And that would most likely be a -- a significant factor, sir?

MR. DAVID MAKARCHUK: If it's in today's environment, at 7 percent, there's probably some fairly significant credit things going on, but sure.

DR. BYRON WILLIAMS: Mr. Johnston, I wonder if I could direct your attention to figure DCAT 66. And, do you -- Mr. Johnston, you have that -- you -- you -- before you?

MR. LUKE JOHNSTON: I do. Thank you.

DR. BYRON WILLIAMS: And sir, this is -- for the purposes of the DCAT analysis, an analysis done by the Manitoba Public Insurance of Canadian consumer price index changes in two (2) different time periods, one (1) flowing from 1915 to 1991, and the second from 1992 to 2017, agreed?

MR. LUKE JOHNSTON: That's correct. Yeah.

DR. BYRON WILLIAMS: And this is one (1) of those -- it's a made-in-Manitoba innovation, in some ways, Mr. Johnston, in terms of how we undertake the DCAT analysis, agreed?

MR. LUKE JOHNSTON: This -- this piece, in particular, this was collaborated on, but everybody has this data. So I suspect a lot of peop -- a lot of folks doing an inflation analysis would consider 1990 to 2017 more relevant in the history. Maybe not ignore all of it, but more relevant, for sure.

DR. BYRON WILLIAMS: Thank you. And sir, when we see the term 'standard deviation', would I be -- or would it be correct to suggest to you that that is a number used to tell how measurement -- measurements for a group are spread out from the average, or the mean?

MR. LUKE JOHNSTON: That's true. Yes.

DR. BYRON WILLIAMS: And sir, when I use the term 'mean', or 'average', or 'expected value', would I be correct in -- or would -- would it be correct to suggest that you calculate that by totalling all the values in the data set, and then dividing that total by the number of values that make up the data set, sir?

MR. LUKE JOHNSTON: Yes.

DR. BYRON WILLIAMS: And Mr. Johnston -- sorry, Mr. Johnston?

MR. LUKE JOHNSTON: Yeah, there's a 'T' in there. Yeah.

DR. BYRON WILLIAMS: There's a 'T' in

there?

MR. LUKE JOHNSTON: Yeah. There is one, yeah. Yeah.

DR. BYRON WILLIAMS: I -- I can't believe we've been doing this for years.

MR. LUKE JOHNSTON: Exactly. Yeah. It makes a big difference, actually, yeah. Yeah.

DR. BYRON WILLIAMS: Yes. Yes. So we'll amend the record, and you have my sincere apologies. Mr. Johnston -- I'm sure it does make a difference.

In terms of the term 'volatility', would it be correct to suggest that it measures the variance of outcomes from the average?

MR. LUKE JOHNSTON: That's fair.

DR. BYRON WILLIAMS: Okay. And it's -- and it -- we often do that analysis via square roots?

MR. LUKE JOHNSTON: Via, sorry, what?

DR. BYRON WILLIAMS: Square roots.

MR. LUKE JOHNSTON: Yes. Yeah.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Mr. Makarchuk,

hopefully I'm not brutalizing your last name as much as Mr. Johnston, but if I wanted to determine the volatility of nominal interest rates, sir, I'll suggest to you and ask you to agree that the volatility equation says that the volatility of nominal interest rates depends on three (3) factors, one (1) being the volatility of real interest rates, two (2) being the volatility of inflation, and three (3) being the correlation between real interest rates and inflation, agreed?

MR. DAVID MAKARCHUK: I prefer that we use the term 'volatility of returns' as opposed to rates, but otherwise, agree --

DR. BYRON WILLIAMS: Okay.

MR. DAVID MAKARCHUK: -- assuming we're talking about Government of Canada issues with no credits or other liquidity considerations.

DR. BYRON WILLIAMS: Thank you. If I could ask Ms. Schubert, Kristen, to -- to take us back to Appendix 17, Attachment A, slide 11.

And Mr. Makarchuk, I can take you back to the front page of this slide if you need it, but you'll accept, subject to check, that this is, again, an excerpt from the November 8th draft that we discussed earlier, sir?

MR. DAVID MAKARCHUK: It is.

DR. BYRON WILLIAMS: And sir, I'll suggest to you that what this page is -- is representing, at least in part, is an effort by Mercers to evaluate financial risk and find portfolios to minimize them by developing, in this case, fixed income portfolios that attempt to reproduce the fluctuations of the liabilities.

Would that be fair, sir?

MR. DAVID MAKARCHUK: Correct. At this stage, we had collected the cash flow information from MPI. We had done some analysis on that cash flow information, learned about their inflation sensitivities. If the inflation rate was to be fixed, then we had the nominal liability benchmark for their consideration. If the inflation rate was to be variable, then there was the real liability benchmark for their consideration.

DR. BYRON WILLIAMS: And so backing away from the specific liability benchmarks, first -- a -- a moment, sir. You are trying to establish here a proxy for liabilities for the purpose of identifying and measuring risk. Would that be fair?

MR. DAVID MAKARCHUK: That'd be fair.

DR. BYRON WILLIAMS: And whether one

was choosing the nominal liability benchmark, or the real liability benchmark at this stage of the analysis, the intent of the portfolio would be to take much of Manitoba Public Insurance's interest rate risk off the table. Would that be fair?

MR. DAVID MAKARCHUK: I think it was premature at this stage in the project to specifically say what they were trying to achieve. We were trying to find a liability benchmark that best represented the obligation so that subsequent to that, MPI could make a decision as to how much risk they did or did not want to retain, and whether they wanted to retain inflation risk or not.

DR. BYRON WILLIAMS: Fair enough, sir, and -- and thank you for that clarification.

When we look at both the nominal and real liability benchmarks, they both had a duration of ten point-three (10.3) years?

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: Does that tell us that bonds, let's say under the nominal liability portfolio with a duration of ten point three (10.3) years, minimize the liability asset mismatch? Is that what this is telling us, sir?

MR. DAVID MAKARCHUK: It's telling us

that when we look at all of the aggregate cash flow data that MPI provided to us, and we project it out into the future, it has a duration measure of ten point-three (10.3) years. So it's not about the bonds yet. It's just about the obligation.

DR. BYRON WILLIAMS: Okay. Thank you. It's about the liabilities?

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: And my apologies for my imprecision. Thank you for correcting me.

In footnote number 1, sir, you'll see a reference that nominal considers fixed future inflation at 2 percent, agreed?

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: And footnote number 2 suggests that real reflects sensitivity to future inflation rates?

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: I wonder if you could assist my client in understanding with regard to the nominal liability benchmark, what was the assumption of inflation volatility, sir?

MR. DAVID MAKARCHUK: The assumpt -- with regard to the nominal?

DR. BYRON WILLIAMS: The nominal.

MR. DAVID MAKARCHUK: It would be zero. No, and -- no volatility for inflation.

DR. BYRON WILLIAMS: And sir, in terms of the real liability benchmark, what was the assumption of inflation volatility?

MR. DAVID MAKARCHUK: It would be on a page that's probably a couple after this, or a couple before it. It's the volatility of the real liability benchmark. I'm not sure if you have that handy or if -- I can dig for it. It should be coming up here.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Your submissions --

MR. DAVID MAKARCHUK: Here --

DR. BYRON WILLIAMS: -- go ahead, sir.

MR. DAVID MAKARCHUK: -- I'm not sure if you're controlling the slides, or whether you just want to move on.

DR. BYRON WILLIAMS: I'm not controlling the slides.

MR. DAVID MAKARCHUK: Do we want to find that number? Is that -- it would be the minimum liability benchmark. I would go back in this presentation.

(BRIEF PAUSE)

MR. DAVID MAKARCHUK: It's Wednesday.

DR. BYRON WILLIAMS: So -- so efficiency-wise, sir, I wonder, perhaps at the break, if we can -- rather than searching for that right now, if we can come back to that. Would that be satis ---

MR. DAVID MAKARCHUK: It would be most easily found in our file report to 84 and 85. It's definitely in there.

DR. BYRON WILLIAMS: Okay.

MR. DAVID MAKARCHUK: So...

DR. BYRON WILLIAMS: Mr. -- and I don't know if this will help you or not, sir, but if we can go to part 6 investment, Appendix 17, Technical Conference Responses, page 3. Go down to question 3, Kristen.

You will see here, sir, a reference to the inflation volatility assumption was 2.6 percent.

Is -- is this the volatility assumption that you were referring to, sir?

MR. DAVID MAKARCHUK: So I would prefer to check. This was back from March. It's possible this is just the volatility assumption for real return bonds.

It's possible it's the inflation assumption -- or the volatility assumption for the liability benchmark, which is roughly two-thirds real return bonds.

DR. BYRON WILLIAMS: So what I'm going to ask, because we've had trouble identifying where this volatility assumption is, sir, for your real liability benchmark.

So I am going to ask by way of undertaking whether Mercer's can provide the volatility assumption for the real liability benchmark prepared for Appendix 17, Attachment (a).

MR. STEVE SCARFONE: Yes, Mr. Williams, we've made a note of that. We thought perhaps that we could point to a document right now, but I don't -- no. So we will make that undertaking.

--- UNDERTAKING NO. 10: Mercer to provide the volatility assumption for the real liability benchmark prepared for Appendix 17, Attachment (a)

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: And, sir, still staying with the -- page 3 of the Technical Conference response, if you could also either -- by -- verbally now or by way of undertaking provide an explanation of what the inflation volatility assumption of 2.6 percent referred to in page 3 of this response is related to, by way of undertaking, would you be prepared to do that as well?

MR. DAVID MAKARCHUK: Perhaps, although I will note that was a question for MPI and not for Mercer's. So, I might need some help from my friends.

MR. STEVE SCARFONE: Yes, Mr. Williams. So it will either be the inflation volatility or the reliability benchmark, one of the two. Is that...

DR. BYRON WILLIAMS: So what -- just for clarity for the court reporter, we have two (2) separate undertakings: One is for the -- the -- the volatility assumption used in attachment A to Appendix 17.

The second is an explanation --

MR. STEVE SCARFONE: Where that number came from.

DR. BYRON WILLIAMS: -- of what the inflation volatility assumption of 2.6 percent, what model it applies for and what -- what it is used for.

MR. STEVE SCARFONE: Yes.

--- UNDERTAKING NO. 11: Mr. Makarchuk to provide an explanation of what the inflation volatility assumption of 2.6 percent, what model it applies for and what it is used for

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Mr. Bunston I'm sure could do that more elegantly than I did, but...

In terms of the -- I have a reference for this if Manitoba Public Insurance requires it, but I'm going to suggest to you that this figure of 2.6 percent represents the model annualized volatility of future period increases, and that the 2.6 percent volatility corresponds to the compounded annualized volatility over the next ten (10) years. It's PUB 1-83, if you're looking for a reference.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: In terms of trying to understand the derivation for this total, the 2.6 percent, I'm suggesting to you corresponds to the compounded annualized volatility projected over the next ten (10) years, agreed?

MR. STEVE SCARFONE: Perhaps just give Mr. Makarchuk an opportunity to review the answer that his firm provided there.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Mr. Makarchuk...?

MR. DAVID MAKARCHUK: Sorry, I've not found the 2.6 where I expected to find it...

MR. BYRON WILLIAMS: Okay.

MR. DAVID MAKARCHUK: ...in my background piece. I see that.

If that's something I could take away or deal with at the break, I'd appreciate that.

DR. BYRON WILLIAMS: Yes.

And we're not going to do this as an undertaking quite yet, because I think -- well, I'll leave it to MPI, can we just come back at the break with this answer without a formal undertaking?

MR. STEVE SCARFONE: Yes, it sounds as

though Mr. Makarchuk is going to be able to provide that.

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Mr. Makarchuk, going back to that slot. Yes, thank you.

At a high level, can you outline the differences in the modeling exercise undertaken between the real liability benchmark and the nominal liability benchmark, leaving aside the assumption about inflation volatility, any other differences, sir?

MR. DAVID MAKARCHUK: Inflation assumption difference is the only difference between these two (2) liability benchmarks.

DR. BYRON WILLIAMS: Okay, thank you. If we can go to slide 24 of this same document.

And Mr. Makarchuk, I'm going to suggest to you that this slide contemplated Mercer's undertaking certain tests, stress tests, scenarios, including a market correction and inflation shock, among others. Agreed?

MR. DAVID MAKARCHUK: Yes, that was the next steps on this page.

DR. BYRON WILLIAMS: And sir, was that

analysis done?

MR. DAVID MAKARCHUK: I'm not 100 percent sure that it was. At this point there is a discussion of stress tests scenarios, but this was not the deck that delivered those results.

I believe it was done, from memory, it was not part of our final presentation. I know it was not part of our final presentation.

DR. BYRON WILLIAMS: So sir, could you, by way of undertaking, confirm whether or not these stress test scenarios were done?

MR. DAVID MAKARCHUK: Yes, I think we can add that to our list.

DR. BYRON WILLIAMS: And if they were done, subject to any proprietary information, could you undertake to provide those stress test analysis?

(BRIEF PAUSE)

MR. STEVE SCARFONE: Just for clarification, Mr. Williams, the undertaking is to provide the results of the stress tests if Mercer conducted them, correct?

DR. BYRON WILLIAMS: Yes. And so the undertaking is a) to confirm whether or not the stress tests portrayed on Slide 24 of Appendix 17, Attachment (a) were undertaken, and if so, to provide them.

And I'll add a third element. If they weren't done -- if -- if -- if Mercer is aware of the reasons why they were not done.

MR. STEVE SCARFONE: To provide the reasons?

DR. BYRON WILLIAMS: Yes.

MR. STEVE SCARFONE: Yes.

--- UNDERTAKING NO. 12: Mercer to confirm whether or not the stress tests portrayed on Slide 24 of Appendix 17, Attachment (a) were undertaken, and if so, to provide them. And if they weren't done, if Mercer is aware of the reasons why they were not done.

MR. STEVE SCARFONE: To provide the reasons?

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Sir, just if we look at stress test scenario, the second one there described as inflation shock, you see reference to high inflation, higher yields.

Do you see that reference, sir?

MR. DAVID MAKARCHUK: I do.

DR. BYRON WILLIAMS: And when you suggest higher inflation would result in higher yields, would it be correct to presume you were referring to nominal yields?

MR. DAVID MAKARCHUK: That's what's implied here, yes.

DR. BYRON WILLIAMS: Would it also be fair to say -- suggest, sir, that in the high inflation scenario real yields might actually fall because of the inverse relation between yields and rises in prices?

MR. DAVID MAKARCHUK: They could fall or rise, depending on how you chose to define the scenario.

There's higher price to earning ratios. So this is a situation where we're trying to illustrate a significant shock to the economy because of runaway inflation or other factors.

DR. BYRON WILLIAMS: And does that

higher price to earning ratios, sir, refer to stock prices?

MR. DAVID MAKARCHUK: Yes, it's not referring to bonds.

DR. BYRON WILLIAMS: And is the inference that stock prices would -- would rise in that stocks offer some inflation protection over longer-term horizons?

MR. DAVID MAKARCHUK: Not necessarily. I think this is saying if there is a lot of inflation in the system, one (1) of the things that might happen is that there's higher price-to-earnings ratios, perhaps because earnings are going down for publicly traded stocks.

So there's a few different things I think one could infer drives that simulation.

DR. BYRON WILLIAMS: Thank you. If we could go back to Appendix 17, Attachment (a), Slide 11.

And sir, you -- we have already talked about the duration of about ten (10) years for nominal and -- and real liability benchmarks portrayed on this slide, agreed?

MR. DAVID MAKARCHUK: Yes.

DR. BYRON WILLIAMS: And duration

measures the impact of changes in interest rates on the market value of fixed income assets, correct?

MR. DAVID MAKARCHUK: Duration need not be a measure of the assets. In this case it was the liabilities.

DR. BYRON WILLIAMS: Yes, there I go again.

Generally, sir, it measures the impact of changes in interest rates on the liabilities?

MR. DAVID MAKARCHUK: That's right. It's sometimes implied that their average term is 10.3 years, that's technically not what it is, though that's not a bad approximation. It measures the relative percentage change that is associated with industry shift.

DR. BYRON WILLIAMS: And so what this would tell us, sir, in the context of a liability ---

MR. DAVID MAKARCHUK: Or any ---

DR. BYRON WILLIAMS: Yes, but lets focus on liabilities with the ten-year dur -- duration, is that a 1 percent change in interest rates roughly causes a 10 percent change in the Basic liability. Agreed?

MR. DAVID MAKARCHUK: Materially, yes, I agree.

DR. BYRON WILLIAMS: Sir, would it also be fair to suggest that duration is higher for liabilities and assets that have more distance cash flows into the future?

MR. DAVID MAKARCHUK: Yes, I would agree with that. Similar to the rule of thumb I just described so.

DR. BYRON WILLIAMS: And so, just for greater clarity on this point, and I thank you for that, if duration is a weighted average of the timing of cash flows, then a duration of 10 for Basic liabilities means that a lot of the clash -- cash flows we're worried about are longer than ten (10) years.

Would that be fair?

MR. DAVID MAKARCHUK: Right. In simple terms, this is not precise, but roughly half of them are shorter than ten (10) years, and roughly half of them are longer than ten (10). There would be a present value consideration in that regard.

DR. BYRON WILLIAMS: And some of them would be extending out well beyond ten (10) years, sir, in terms of cash flows?

MR. DAVID MAKARCHUK: Certainly, I assume there's probably some claimants who are still quite young, probably some could be as long as fifty (50) years.

DR. BYRON WILLIAMS: And just for Mr. Johnston, I think it's CI-7-25 is the -- yes, just go down to the bottom of that page.

And Mr. Johnston, I'm directing your attention to figure CI-2, which discusses the percentage of total ultimate paid in each year.

Do you have that in front of you, sir?

MR. LUKE JOHNSTON: I do.

DR. BYRON WILLIAMS: And, Mr. Johnston, if we take line 1, accident benefits, weekly indemnity and head out all the way to the right, does that suggest that the percentage of total ultimate paid in terms of this particular cover 48 percent of it extends beyond ten (10) years?

MR. LUKE JOHNSTON: Yes, our -- that's our expectation on the -- what percentage of payments would be beyond ten (10) years, yes.

DR. BYRON WILLIAMS: And similarly, sir, if we took line number 2, accident benefit other indexed and moved all the way out to the extreme right, this suggest that your expectation is that 39 percent of the total ultimate paid will be beyond (10) years, ten (10) years and beyond?

MR. LUKE JOHNSTON: That's correct.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Mr. Makarchuk, when we're thinking of the exercise that Mercer's performs for its clients, one -- one -- one (1) element is the development of a liability benchmark portfolio as a proxy for liabilities to identify and measure the risks, agreed?

MR. DAVID MAKARCHUK: Agreed.

DR. BYRON WILLIAMS: And then an important second step is to optimize the portfolio, and that's about managing that risk, correct?

MR. DAVID MAKARCHUK: It's about identifying the risks and the opportunities and then making asset decisions, sure.

DR. BYRON WILLIAMS: And distinguishing between those separate steps, one, doing the liability benchmark, and secondly, optimizing the portfolio, the ultimate choice in optimizing the portfolio may be not to invest in the same assets as those in the liability benchmark portfolio. That's conceivable?

MR. DAVID MAKARCHUK: Yes, many

investors invest in assets, not in the liability benchmark.

DR. BYRON WILLIAMS: And so it's important to maintain analytic distinction between those two (2) steps, sir?

MR. DAVID MAKARCHUK: Right. The liability and modeling decision is separate from the asset class investment decisions.

DR. BYRON WILLIAMS: And the optimal asset allocations that flow from an optimizing process, in this case, could depend materially on whether a nominal or real liability benchmark is selected initially, agreed?

MR. DAVID MAKARCHUK: There's certainly a number of factors, return, risk, cost and time factors that ultimately decide or determine the -- the final portfolio. But otherwise, yes, the liability benchmark is an important foundation for that discussion.

DR. BYRON WILLIAMS: Kristen, if you could pull up the CAC second round Information Request 2-3, please.

And I wanted to direct you -- Kris, it's CAC-MPI 2-3. And I want to start on the first page under question, under tracking errors.

Mr. Makarchuk, do you see that?

MR. DAVID MAKARCHUK: I do.

DR. BYRON WILLIAMS: And generally, sir, can we agree that tracking errors measure the standard deviation of the return difference between two (2) groups of assets or liabilities?

MR. DAVID MAKARCHUK: It's not my preferred use of the term "tracking error," but it's the context in which the question was phrased.

DR. BYRON WILLIAMS: What term would you prefer, sir?

MR. DAVID MAKARCHUK: For --

DR. BYRON WILLIAMS: Well, let's try this again --

MR. DAVID MAKARCHUK: For the delta between the nominal liability benchmark and the real liability benchmark?

DR. BYRON WILLIAMS: Yes. For the anticipated volatility between the two (2) portfolios.

MR. DAVID MAKARCHUK: So they're both benchmarks on their own; neither of them is a portfolio, per se. They would have different characteristics in terms of future -- future returns and future volatility.

I don't mind calling it a tracking

error for the purpose of today's conversation.

DR. BYRON WILLIAMS: Okay, thank you. And going to the response to (a), when Mercers evaluated the tracking area -- sorry.

For the purposes of this conversation, the tracking error or the variation in future returns between the nominal liability benchmark and the real liability benchmark as summarized via the anticipated volatility, the anticipated volatility between these two (2) portfolios using forward rate assumptions is 4.5 percent; agreed?

MR. DAVID MAKARCHUK: Yes, that's what it says, yeah.

DR. BYRON WILLIAMS: And I take it Mercers never undertook such a calculation in terms of the anticipated volatility between these -- these two (2) portfolios using the standard in interest rate forecast?

MR. DAVID MAKARCHUK: I think the IR was to use the forward assumptions.

DR. BYRON WILLIAMS: Okay.

MR. DAVID MAKARCHUK: I doubt that we did it otherwise.

DR. BYRON WILLIAMS: And had you undertaken this analysis before it was requested by my client, sir?

MR. DAVID MAKARCHUK: I don't believe so. We -- we did compare and contrast the real and liability in nominal liability benchmarks. You showed me some of those slides earlier. I don't believe we specifically calculated the difference in the volatility between the two (2).

DR. BYRON WILLIAMS: Okay. Thank you.

I wonder, Ms. Schubert, if you can turn to PUB-MPI 1-86.

And, Mr. Makarchuk, I know you were asked a few questions about some of these issues by My Learned Friend Ms. McCandless, yesterday.

But if we go to question B for a second, you'll see that an explanation is being sought in terms of why the forward curve interest rate was used rather than Mercer's standard interest rate forecast, agreed?

MR. DAVID MAKARCHUK: I see that, yeah.

DR. BYRON WILLIAMS: And actually, I think this question may be more properly put the MPI. I'm not sure so.

But going to -- in terms of the answer, Mr. Bunston, I don't know if this is you or Mr.

Makarchuk, but in terms of the answer no, why not, the -- directing your attention to the second and third line, the Corporation believed that the more modest increase in interest rates reflected in Mercer's forecast based upon the forward curve was more realistic; agreed?

MR. DAVID MAKARCHUK: That's correct, yes.

DR. BYRON WILLIAMS: And then the next line suggests that use of Mercer's standard interest rate forecast resulted in capital losses for the fixed income holdings. Agreed?

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: Now, Mr. Makarchuk or Mr. Bunston, can you explain why that -- that would've happened?

MR. STEVE SCARFONE: Just to be clear, why -- what would've happened? Capital losses for the fixed income holdings?

DR. BYRON WILLIAMS: Yes, why would capital losses for the fixed income holdings have flowed from use of Mercer's standard interest rate forecast?

MR. GLENN BUNSTON: Well, that was because Mercer's standard interest rate forecast assumed that a reversion to mean. So long term interest rate to -- to the average long-term interest rate, just as the banks have forecasted for some time and rising interest rates cause the market value of bonds to fall.

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Okay. And does Manitoba Public Insurance have the results of the implications for its portfolios in the event that Mercer's standard interest rate forecasts were used? These results were shared with you.

MR. GLENN BUNSTON: We had some preliminary results based on the standard interest rate forecast, yes.

DR. BYRON WILLIAMS: Would Manitoba Public Insurance be prepared to provide those by way of undertaking?

MR. STEVE SCARFONE: Yes. That's an undertaking we're prepared to make, provided Mercer doesn't have any concerns about any confidentiality issues that might arise from that undertaking.

MR. DAVID MAKARCHUK: I believe this was -- your question was somewhat a parallel analysis using our standard interest rate forecast as opposed to the forward rates. Is that correct?

DR. BYRON WILLIAMS: That's right.

MR. DAVID MAKARCHUK: We would have no concerns specific to that point.

DR. BYRON WILLIAMS: So just in terms of clarifying the undertaking, we're asking for the analysis as referred to in PUB-MPI-1-86, based upon use of Mercer's standard interest rate forecast rather than the forward curve, agreed?

MR. STEVE SCARFONE: Agreed. To the -- Mr. Bunston said that he had some of those -- that analysis in his possession.

--- UNDERTAKING NO. 13: MPI to provide the analysis as referred to in PUB-MPI-1-86, based upon use of Mercer's standard interest rate forecast rather than the forward curve

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Mr. Makarchuk, I take it that for the purposes of this analysis Mercers would not recommend just assuming interest rates stayed flat?

MR. DAVID MAKARCHUK: Could you repeat the question, please?

DR. BYRON WILLIAMS: In doing an analysis like this, as opposed to using the forward curve or the standard interest rate forecast, Mercers would not recommend using -- doing such analysis -- analysis, assuming that interest rates stayed flat?

MR. DAVID MAKARCHUK: We would not recommend doing analysis, assuming interest rates stay flat or constant.

DR. BYRON WILLIAMS: Why not?

MR. DAVID MAKARCHUK: The curve is made up of many different points, our expectation -- our standard interest rate forecast, which all of our investment professionals or actuarial professionals across Canada use are based on our national assumptions. They were part of the package. We assume as a firm that there will be a gentle rise in the yield curve over the next few years returning to equilibrium, at some point, that's our firm view.

DR. BYRON WILLIAMS: Thank you. MPI, if you need a reference for this, it's the second page of CAC-2-29. And just scroll down a bit more, Kristen, thank you.

Would it be accurate to suggest that MPI's investigations of the SAAQ investment portfolio as of December 31st, 2017, suggested that within their fixed income portfolio of -- that there was about 10 percent in real return bonds?

MR. LUKE JOHNSTON: Yes, that's -- we just asked the question and this is the information they gave, yeah.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Mr. Makarchuk, you'll recall our discussion of the liabilities of Manitoba Public Insurance and the reality that -- that a significant part of them, in terms of -- extend out beyond ten (10) years.

You remember that conversation, sir?

MR. DAVID MAKARCHUK: I do.

DR. BYRON WILLIAMS: And those liabilities, being those extending beyond ten (10) years, are inherently more challenging to predict just given the passage of time, sir.

What will happen to those liabilities?

MR. DAVID MAKARCHUK: Certainly it's mortality and other impacts that make them less certain than those in the next year or two (2), yes.

DR. BYRON WILLIAMS: In Mercer's analysis was there any constraint imposed that would say some smaller allocations in terms of real return bonds couldn't be made to hedge the longest part of the liability cash flow stream?

MR. DAVID MAKARCHUK: There were no constraints on real return bonds in the asset liability work that we did.

DR. BYRON WILLIAMS: And was Mercers asked to consider a two-tiered duration policy, involving both real and nominal assets?

MR. DAVID MAKARCHUK: To model the liabilities or to determine asset portfolios?

DR. BYRON WILLIAMS: To model -- sorry, to determine asset portfolios.

MR. DAVID MAKARCHUK: Can you say the question again with the "determine asset portfolios," please.

DR. BYRON WILLIAMS: For the purpose of determining asset portfolios, was Mercers asked to consider a two-tiered duration policy involving real and nominal assets?

MR. DAVID MAKARCHUK: We never discussed a two-tiered duration policy.

DR. BYRON WILLIAMS: Mr. Chair and members the panel, subject to my review of notes, I think those are my questions for the witness from Mercers.

There was one (1) question that we were going to see if we could get an answer to over the break. So I'm just wondering if that might be an appropriate time to take a break?

THE CHAIRPERSON: So why don't we take twenty (20) minutes and you can discuss it with the witness and with MPI and see if we can get the answer on the record while he is here.

Then I assume that you're done with Mr. Makarchuk?

DR. BYRON WILLIAMS: There are undertakings, but I am -- we'll have to figure how to proceed if there's any cross-examination or --

THE CHAIRPERSON: Okay, we will adjourn for twenty (20) minutes.

--- Upon recessing 2:15 p.m.

--- Upon resuming at 2:46 p.m.

THE CHAIRPERSON: Okay, if we can resume. Mr. Williams, were you able to talk to MPI about the issues?

DR. BYRON WILLIAMS: So, first of all, just in terms of the confidential, we'll do that via writing, and we'll see if --

THE CHAIRPERSON: Okay.

DR. BYRON WILLIAMS: -- the proposed undertaking is satisfactory.

There was one (1) question out -- outstanding relating to the source -- relating to the 2.6. And I don't know if, Mr. Makarchuk, you have any more information you can share with us.

MR. STEVE SCARFONE: If we could -- so I think what Mr. Williams is referring to is the Information Request MPI -- or sorry PUB-1-8-3.

DR. BYRON WILLIAMS: Yes, that's correct.

MR. STEVE SCARFONE: If we could pull that up just for a second so we have it before the witness. And just scroll down -- or scroll up, please.

So the question, as I understood it -- and I don't believe, Mr. Williams, that an official undertaking was given on this particular question that you had, but it reads:

"The inflation volatility assumption

was 2.6 percent."

And our understanding was you wanted confirmation from Mercer what that 2.6 entailed; is that correct?

DR. BYRON WILLIAMS: Yeah, and just -- if we can go really to the bottom of this -- this slide, I didn't -- I wanted confirmation that the 2.6 percent volatility estimated corresponds to the compounded annualized volatility estimated over the next ten (10) years.

MR. DAVID MAKARCHUK: Correct.

DR. BYRON WILLIAMS: Okay, that was easy.

MR. STEVE SCARFONE: And I do believe --

DR. BYRON WILLIAMS: -- do have undertakings related to this, in terms of how it was used in the models but that -- that was all we were trying to get at here.

MR. STEVE SCARFONE: Yes, and then -- so I wanted to -- that's exactly what I wanted to clarify, is that we've answered the question that wasn't provided by way of undertaking. The balance of the answers that Mercer will provide will come later.

DR. BYRON WILLIAMS: Yes, and there

are no -- yes, that's correct.

From our clients' perspective Mr. Makarchuk can be excused with thanks. We're not speaking for the Board.

MR. DAVID MAKARCHUK: Thank you.

THE CHAIRPERSON: I'll ask the Board if -- if the Board has any questions? No...?

Mr. Scarfone, do you have any redirect for Mr. Makarchuk?

MR. STEVE SCARFONE: I do have one (1) question on redirect. If Kristen could pull up CAC-2-2-9, please.

RE-DIRECT EXAMINATION BY MR. STEVE SCARFONE:

MR. STEVE SCARFONE: And this, Mr. Makarchuk, if you can scroll down to the answer, Kristen, please.

This was the question, Mr. Makarchuk -- or a document that was shown to -- to us earlier about a profile that the Quebec jurisdiction has in its investment -- its fixed income portfolio specifically -- that shows a composition of real return bonds of 10 percent.

Do you see that, sir?

MR. DAVID MAKARCHUK: I do.

MR. STEVE SCARFONE: Would you agree, sir, that any particular investment portfolio, including a fixed income such as the one shown before us, will depend largely on the risk profile that that particular investor has?

MR. DAVID MAKARCHUK: I'd agree with that.

MR. STEVE SCARFONE: Thank you. And that was my only question on redirect.

THE CHAIRPERSON: Thank you, Mr. Makarchuk. Thank you for your assistance, you may be excused.

MR. DAVID MAKARCHUK: Thank you.

(WITNESS DAVE MAKARCHUK STANDS DOWN)

THE CHAIRPERSON: Mr. Williams, did you want to resume your cross-examination?

DR. BYRON WILLIAMS: I did. Thank you, Mr. Chair and members of the panel. I did want to introduce four (4) exhibits. The first which we would propose be marked as CAC Exhibit 14 is a one (1) page speaking of -- to the Bank of Canada raising overnight rate target to 1 1/2 percent.

--- EXHIBIT NO. CAC-14: One (1) page speaking to the Bank of Canada raising overnight rate target to 1 1/2 percent.

DR. BYRON WILLIAMS: The second is a excerpt from a October 2016 PowerPoint of Dr. Sean Cleary titled Interest Rate Forecast Issues and we would recommend that be marked as CAC Exhibit 15.

--- EXHIBIT NO. CAC-15: Excerpt from a October 2016 PowerPoint of Dr. Sean Cleary titled Interest Rate Forecast Issues

DR. BYRON WILLIAMS: Next are excerpts from PUB Board Orders 128/'15, 162/'16 and 130, should say, 17, excuse me, and that is CAC Exhibit 16.

And would just indicate that the tab 3 should say 130/'17 not 7.

--- EXHIBIT NO. CAC-16: Excerpts from PUB Board Orders 128/'15, 162/'16 and 130/'17

DR. BYRON WILLIAMS: And finally, is an exhibit from when I was young, CAC Exhibit 17, which is from Board Order 151/00.

--- EXHIBIT NO. CAC-17: Board Order 151/00

DR. BYRON WILLIAMS: If that's satisfactory to the Board, I'm ready to proceed.

THE CHAIRPERSON: Thank you.

CONTINUED CROSS-EXAMINATION BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Just for MPI, I'm -- I'm now going to the interest rate forecast, and I don't know, Mr. Johnston, will that be you?

MR. LUKE JOHNSTON: It could really be anyone on the panel but, yeah.

DR. BYRON WILLIAMS: Then I'll just -- I'll direct it generally to the panel, then.

Defining monetary economics to include -- involve the study of the rule of money and the financial system in -- in the economy, including the role of interest, would it be fair to say that the MPI panel does not profess expertise in monetary economics?

MR. LUKE JOHNSTON: I -- I do not. I

won't for the rest but I would assume they would have a similar answer.

MR. GLENN BUNSTON: Well, I'm a chartered financial analyst but I'm not an economist.

DR. BYRON WILLIAMS: So you do not profess expertise in monetary economics as so defined, sir?

MR. GLENN BUNSTON: I do not.

DR. BYRON WILLIAMS: Mr. Giesbrecht...?

MR. MARK GIESBRECHT: I also do not.

DR. BYRON WILLIAMS: And defining time series econometrics as the use of statistical methods and estimates and test models of the evolution of economic outcomes such as interest rate, does anyone on the MPI panel profess expertise in time series econometrics?

MR. MARK GIESBRECHT: I do not.

MR. LUKE JOHNSTON: That specific topic, expertise no but actuarial science would -- involves, as you know, quite a bit of statistics and modelling so not that topic, but statistical concepts in general, yes.

DR. BYRON WILLIAMS: And in -- and including some time series analysis?

MR. LUKE JOHNSTON: That's right, yeah.

MR. GLENN BUNSTON: No, I do not profess to be an expert in time series economics or --

DR. BYRON WILLIAMS: Econometrics.

MR. GLENN BUNSTON: Econometrics. Thank you.

DR. BYRON WILLIAMS: Ms. Schubert, if we could turn to part 6, section 16.1 of investments, page 78. That's not the page. Just one (1) second. I'm just going to step away from the mic for a second.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: I'll just indicate Ms. Schubert has done a phenomenal job reading my messy handwriting. I take full ownership for the -- for the glitch.

Mr. Johnston, you've spoken a lot about interest rate risk during the course of this hearing, sir.

MR. LUKE JOHNSTON: I have, yes.

DR. BYRON WILLIAMS: And leaving aside issues related to the interest rate forecast, one (1) of the efforts that Manitoba Public Insurance has made to address issues related to interest rate risks took place on or about 2014, when it changed the duration bandwidth from plus or minus two (2) years to plus or minus one (1) year. Do you recall that, sir?

MR. LUKE JOHNSTON: That was an evolution, but the -- the idea of just matching would have come before that, even, but -- so this is making that policy even -- even tighter, yeah.

DR. BYRON WILLIAMS: And then a -- a second element of that change, sir, in terms of addressing interest rate risk, was to attempt to match the duration of the fixed income portfolio to the corporate claims liability duration on or about 2015?

MR. LUKE JOHNSTON: That's right.

DR. BYRON WILLIAMS: And a third pending step relates to the segregation of the commingled investment portfolio, so the matching in terms of Basic liabilities becomes more precise, agreed?

MR. LUKE JOHNSTON: Agreed. If I'm -- and if -- if I could just add to that, predating even some of this work, we -- MPI didn't even have the capability to model interest rate impacts, and that was a concern of the -- the PUB and MPI, so the -- the models to even do -- do this work were probably around the 2011/2012 period.

DR. BYRON WILLIAMS: And Mr. Johnston, just in -- you'll see the headline on this section relates to reducing interest rate risk has been a focus of MPI since 2014, agreed?

MR. LUKE JOHNSTON: Agreed.

DR. BYRON WILLIAMS: And you'll agree that the Public Utilities Board and others have been partners with MPI in -- in seeking to address interest rate risk since at least that time, sir?

MR. LUKE JOHNSTON: I would -- I would assume so, important risk, yes.

DR. BYRON WILLIAMS: And sir, I want to direct your attention to CAC Exhibit 16, which is the excerpt from the Board Orders. And starting about tab 1, page 43 of 83 of Order number 128/'15. Yes, scroll down. That's perfect, Kristen. Thank you.

And Mr. Johnston, part of your duties in -- in your role at MPI are to follow up on issues relating to interest rate risk that may flow from PUB orders. Would that be fair, sir?

MR. LUKE JOHNSTON: That's fair.

DR. BYRON WILLIAMS: And in your duties, you have to be familiar with Public Utility Board Orders, as they may rely -- relate to -- to your work, and to the extent that the Public Utilities Board provides advice that may be of interest to your duties, agreed?

MR. LUKE JOHNSTON: Yes.

DR. BYRON WILLIAMS: And you see here, sir, without -- go into the second paragraph, starting -- the Board started in Order 151 thir -- 13, the Board, expressing in that Order, the view that the Corporation's current approach to duration mismatching was making it too vulnerable to interest rate risk?

MR. LUKE JOHNSTON: I see that.

DR. BYRON WILLIAMS: And certainly, that was advice that was being provided by the Board to Manitoba Public Insurance?

MR. LUKE JOHNSTON: Agreed.

DR. BYRON WILLIAMS: And if we go down towards the bottom of that page, you'll see a reference from Board Order 135/'14, with the Public Utilities Board, in that Order, advising MPI to seek to substantially immunize itself from the impact of changing interest rates, agreed?

MR. LUKE JOHNSTON: Agreed.

DR. BYRON WILLIAMS: And again, just towards the top of page 44, you see reference to an ALM Study and direction again from this 2014 Order for

MPI to take steps to substantially mitigate interest rate risk, agreed?

MR. LUKE JOHNSTON: Agreed.

DR. BYRON WILLIAMS: If we could go to the -- two (2) more pages in, under "Board findings," and to the third paragraph on that page.

Again, you see the express concern by the Public Utilities Board of the volatility and the value of the investment portfolio, and the concern about interest rate -- rate risk in the fact that Basic was not fully immunized, agreed?

MR. LUKE JOHNSTON: Agreed.

DR. BYRON WILLIAMS: If we can go to Order 162/'16, which is tab 2, and specifically to page 51.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: And towards the bottom of that page, you'll see guidance from the Public Utilities Board and findings in the first paragraph under 4.7 of an ongoing concern with exposure to interest rate risk of Manitoba Public Insurance, sir?

MR. LUKE JOHNSTON: I see that.

DR. BYRON WILLIAMS: And at the bottom of that paragraph, the concern provided that, notwithstanding that the -- Aon recommended ALM strategy provide substantial protection from change in interest rates, that the risk to Basic and its ratepayers remain material, agreed?

MR. LUKE JOHNSTON: Agreed.

DR. BYRON WILLIAMS: If we can go to the third tab, Order 130/'17, page 63, under section 6.5, interest rate risk, the second and third paragraphs.

And sir, you see the Public Utilities Board noting again, from Order 162/'16, its concern with continued exposure to interest rate risk and a view that an ALM study should be conducted more frequently. Do you see that reference, sir?

MR. LUKE JOHNSTON: Yes, I do.

DR. BYRON WILLIAMS: And you'll agree, going down to the next paragraph, that Manitoba Public Insurance did not file an updated asset liability matching study for the purposes of last year's application?

MR. LUKE JOHNSTON: If -- I -- I didn't want to interrupt, because I know you're going to go through this, but if you're done, but if I can just make a comment?

DR. BYRON WILLIAMS: I have one (1) last --

MR. LUKE JOHNSTON: Okay.

DR. BYRON WILLIAMS: -- thing --

MR. LUKE JOHNSTON: I'll let you do that. Yeah.

DR. BYRON WILLIAMS: -- Mr. Johnston, but certainly, thank you for your courtesy.

Just going to page 66 -- and Mr. Johnston, we don't even need to go to the page 63, but you'll agree that one (1) of the findings of the Board in this Order was that given that interest rates have began to rise in recent months, that it does not accept that the naive forecast should be relied on for rate-setting purposes? That's page 69, if you need it, sir.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: I see that now. Yes. Yes.

DR. BYRON WILLIAMS: Okay. And Mr. Johnston, thank you.

MR. LUKE JOHNSTON: Thanks. So just

to be clear, we, the Corporation shares those concerns that the Board has.

To give a little bit of history, we have had a corporate duration matching strategy that matched fixed income assets to our claims liabilities. We did have an issue with how those portfolios were segregated, and that the created some problems on the -- on how -- how gains and losses were allocated by lines of business, which the Corporation admitted, and -- and segregating portfolios is one (1) of the ways to fix that.

For the most part, neutralizing interest rate risk to the claim liabilities themselves has been something that MPI's had in place for some time now, at least since 2014. That strategy does not shield us from the pricing risk of -- of optimistic interest rate forecasts.

So as I talked about yesterday, we can match assets and liabilities as much is we want. We can go right to the cash flow basis, but if we use a poor assumption for pricing, there is no escaping that price that you -- you set here. If it's based on a really high interest rate and priced too low, we will get the consequences of that, and of course, vice versa.

So just to be clear, we can't -- or at least we haven't found a way to -- to shield ourselves from pricing wrong in the first place, but we can definitely match better, as we've shown through the ALM study for the liabilities that we do have, so the prior year risk should be neutralized.

DR. BYRON WILLIAMS: And just where I was going, sir, Manitoba Public Insurance does not wish to leave any inference on the record that the Public Utilities Board has not been vigilant in addressing issues related to interest rate liability matching risk, agreed?

MR. LUKE JOHNSTON: Agreed. I just didn't want the impression that the Corporation didn't also care about this risk, and then do what it could to neutralize it.

DR. BYRON WILLIAMS: And sir, you and I, indeed, have gone through circumstances where it might appear where the Public Utilities Board was urging Manitoba Public Insurance to be more vigilant in terms of liability mis -- mismatches, agreed?

MR. LUKE JOHNSTON: It's -- yeah. It's very clear that this is a major concern to the Board.

MR. MARK GIESBRECHT: If I can also --

excuse me. If I can also just add, in my time with MPI for past year, it's -- it's been clear that both management and our Board do share this concern. It -- it is a -- it's a core fundamental issue of insurance, and especially when you have the long-term liabilities that we have.

And that there's been extensive work done on this in -- in the past number of months, as it is core to what we do. So it -- it -- by no means is it taken lightly. It -- it is a core issue to MPI.

DR. BYRON WILLIAMS: Thank you, Mr. Giesbrecht.

If we can turn, Kristen -- Ms. Schubert, to CAC-1-8, response (a). And Mr. Johnston, MPI is confirming in this response that it does not rely on any authority from the Bank of Canada or the United States Federal Reserve to provide support for the Government of Canada ten (10) year -- ten (10) year bond yield forecast, agreed?

MR. LUKE JOHNSTON: Agreed.

DR. BYRON WILLIAMS: And in terms of question -- you'll also see in answer (b) that MPI does rely upon Dr. Sean Cleary in support of the naive forecast, agreed?

MR. GLENN BUNSTON: That's correct.

DR. BYRON WILLIAMS: And if we could go to CAC Exhibit 15, being the excerpt from the interest rate forecast of -- sorry, the interest rate forecast issues PowerPoint of Dr. Cleary. And thank you, Mr. Bunston, for the -- the assistance.

Going to page 17 of that answer, it's Mr. Cleary's advice -- Mr. Bunston -- sorry -- let me try that again -- Dr. Cleary's advice to the Public Utilities Board back in 2015 was that a 50/50 approach should be employed in terms of interest rate forecasts, sir?

THE CHAIRPERSON: Mr. Williams, I believe it was 2016.

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: 2016, I apologize.

MR. GLENN BUNSTON: But that's the title of the slide here, yes.

DR. BYRON WILLIAMS: And sir, if you go to page 18, at the bottom, the last bullet, you'll see Dr. Cleary describing his view that the 50/50 approach should be used to obtain the best estimate?

MR. GLENN BUNSTON: I -- I see that, and I also see the bullet point above that that says that the naive would have improved the forecasting accuracy significantly, which is shown on the previous page as well, in terms of the -- the errors relative to actuals for SIRF, naive, and 50/50, with naive having the lowest error, at 39 1/2 percent.

DR. BYRON WILLIAMS: Thank you. And Dr. Cleary's advice was for forecasting purposes, 50/50, sir?

MR. GLENN BUNSTON: That was his recommendation at the time, yes.

DR. BYRON WILLIAMS: Do you have any evidence, sir, that his recommendation has changed?

MR. GLENN BUNSTON: I do not, no.

DR. BYRON WILLIAMS: Mr. Bunston, you had a bit of a discussion, I think, this morning with Mr. Oakes about the Bank of Canada.

Do you recall that conversation?

MR. GLENN BUNSTON: I do.

DR. BYRON WILLIAMS: It would be fair to say, sir, that given the nature of its liabilities, MPI must stay attuned to issues related to interest rates and inflation, agreed?

MR. GLENN BUNSTON: Agreed.

DR. BYRON WILLIAMS: And MPI, or you specifically, do not claim expertise with regard to monetary policy, correct?

MR. GLENN BUNSTON: Well, my background as a chartered financial analyst covered economics, it covered investing in fixed-income assets, so I have some knowledge of that area, but I am not a -- I'm not -- not an economist. That's -- no.

DR. BYRON WILLIAMS: And sir, given the role of the Bank of Canada in terms of monetary policy and the economy generally, it's important for MPI to stay abreast of policy statements of the Bank of Canada? Would that be fair?

MR. GLENN BUNSTON: It's important for us to monitor the fixed income and interest rate markets, yes.

MR. LUKE JOHNSTON: That said, there's a lot of comments about expertise being thrown around here. I monitor, but rely completely without, you know, viewing any of, you know, the history or the accuracy of those -- that information would be foolish.

DR. BYRON WILLIAMS: And fair enough, Mr. Johnston. Either to you or Mr. Bun -- Bunston, but it is important for MPI to be aware of statements of the Bank of Canada as they may relate to interest rates and inflation, agreed?

MR. GLENN BUNSTON: Certainly, the Bank of Canada has impacts on inflation and interest rates, so yes.

DR. BYRON WILLIAMS: And those statements may have exp -- effects on expectations in the marketplace, correct?

MR. GLENN BUNSTON: Yes, the Bank of Canada's actions have direct impact on inflation expectations, certainly.

DR. BYRON WILLIAMS: And as an ordinary course of business, MPI would monitor and review quarterly Bank of Canada statements, given concerns over interest rates and inflation, correct?

MR. GLENN BUNSTON: Correct.

DR. BYRON WILLIAMS: And just drawing your attention to CAC Exhibit 14, and in particular, the second paragraph, you see reference to the -- the American economy, the US economy, and reinforcing market expectations of higher policy rates.

Do you see that reference, sir? Line 2 and 3 of the second paragraph?

(BRIEF PAUSE)

MR. GLENN BUNSTON: Yes, I see that.

DR. BYRON WILLIAMS: And then just directing your attention to the last paragraph and the first sentence of this last paragraph on -- on the page, you'll see also, sir, reference of the governing council expecting that higher interest rates will be warranted to keep inflation your target.

Do you see that reference, sir?

MR. GLENN BUNSTON: Yes, I see that.

DR. BYRON WILLIAMS: And of course, you're aware that the Bank of Canada raised overnight rates in July of 2018?

MR. GLENN BUNSTON: I'm aware of that.

MR. LUKE JOHNSTON: Just a note here, this is, again, that forecast. I -- we could, maybe in theory, pull up the last five (5) or six (6) versions of this at the same time, over the last five (5) or six (6) years, and see how those forecasts and projections turned out. I'm guessing not very well. But that's -- again, that's -- that's our point. Regardless of what's being said in some of these documents, it -- it hasn't happened yet.

DR. BYRON WILLIAMS: You're not denying, sir, the two (2) overnight rate increases in -- in the last year. Obviously, that's happened?

MR. LUKE JOHNSTON: Yeah. Obviously anything that's actually occurred, I'm not denying that, nor -- nor are we suggesting that we shouldn't use that. But anything beyond that is a forecast, and pretty much every forecast that's been made by the Bank of Canada, particularly on interest rates in recent years, hasn't performed very well. There might be examples where it has, but in general, all we have to do is pull up that graphic and -- to show the performance.

DR. BYRON WILLIAMS: Okay. Thank you, sir. I wonder if we could turn -- we're switching to issues related to the Capital Maintenance Provision and CAC-2-20(b). And to the second page of that response, without asking MPI to elaborate, and focusing on part 2(b)(2), one (1) of the described purposes of maintaining a certain capital level associated with the Capital Maintenance Provi -- Provision is to protect ratepayers from potential rate shock from future unforeseen adverse events.

You see that reference?

MR. LUKE JOHNSTON: I do.

DR. BYRON WILLIAMS: And Mr. Johnston, for the purposes of this application, how is Manitoba Public Insurance defining rate shock?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: We -- we don't have a -- a formal definition of what defines a rate shock for MPI. The one (1) source I could point to in the DCAT report, in terms of management actions, we assume that anything greater than 5 percent on an overall basis would -- would be not realistic for approval at the -- at the -- at this hearing. So that's -- that's one (1) gauge that we use, but we have no formal definition.

DR. BYRON WILLIAMS: Mr. Johnston, would it be fair to say that Manitoba Public Insurance does not consider a 2 percent rate increase to equate with rate shock?

MR. LUKE JOHNSTON: That -- that's fair, yes.

DR. BYRON WILLIAMS: Assuming a zero overall rate increase and a 2 percent RSR rebuilding fee, would it be fair to suggest that Manitoba Public Insurance does not consider that type of event to be rate shock?

MR. LUKE JOHNSTON: I would not consider a 2 percent combined rate increase and capital maintenance fee to be considered rate shock.

I think -- although we -- we -- we'll do our -- obviously, do our best to control costs, that is basically inflationary type increase.

MR. MARK GIESBRECHT: And just to clarify, there -- there is no rebuilding fee in our application. It is a -- a capital maintenance provision only.

DR. BYRON WILLIAMS: Thank you for that, Mr. -- Mr. Giesbrecht.

If we could go to CAC-2-18, towards the bottom of page 2 of 3, and then to the top of page 3 of 3.

Mr. Johnston, you see this Capital Maintenance Provision, or CMP, being advanced to -- for the purpose of ensuring that the actual capital position does not deteriorate with changes in Basic's risk profile -- file, as measured by the MCT ratio, agreed?

MR. LUKE JOHNSTON: Agreed.

DR. BYRON WILLIAMS: And sir, in terms of the...

(BRIEF PAUSE)

DR. BYRON WILLIAMS: In terms of the

Capital Maintenance Provision, it is not linked to the DCAT. It is linked exclusively to the MCT ratio.

Is that -- am I correct?

MR. LUKE JOHNSTON: That -- that is true, and one (1) of the benefits of that is, again, there is no subjectivity of any kind in that calculation. The -- it is, you know, essentially a financial reported number that can be confirmed and is completely objective. So that's one (1) -- one (1) of the reasons.

MR. MARK GIESBRECHT: If I can just add real quickly, the -- the MCT and the DCAT are not mutually exclusive. In -- in terms of target setting, the -- the DCAT is really what underpins the MCT, and they work hand-in-hand. And so they -- they are not two (2) different things, but they really work together to set your -- your target.

DR. BYRON WILLIAMS: Mr. Johnston, for Dynamic Capital Adequacy Testing purposes, do you model inadequate or failed management pro -- processes?

MR. LUKE JOHNSTON: We do not specifically model those in -- in the results. If there are any of those impacts embedded in claims results or other areas, it is possible that it would feed into the models, but not -- not directly.

DR. BYRON WILLIAMS: If we could go to part 6 of the MPI application, RSR, Appendix 1, MCT. And it -- it should be a table headed "minimum capital test, capital margin required."

And I want to go down to line 30, if you would, Ms. Schubert. Line 30 -- sorry, go back. Yes. So -- this is -- you're on the wrong page, sorry, through -- through my fault. That's perfect, under "operational risk margin." Could you make that just a little bit bigger, Ms. Schubert, please.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Now for the purposes of the MCT calculation, Mr. Johnston, the Office of the Superintendent of Financial Institutions defines operational risk is the risk of loss resulting from inadequate or failed internal processes, people, and system, or from external events.

Would that be fair, sir -- sir?

MR. LUKE JOHNSTON: That's fair.

DR. BYRON WILLIAMS: And in terms of the calculation of the total minimum capital required of -- or the total capital margin required at target, the operational risk margin contributes in the '17/'18 year $70 million. Is that right, sir?

MR. LUKE JOHNSTON: In the amount required at target, so that would be -- you'll see a few things there. There is operational risk margin. Right below it, there's a diversification credit that is approximately the same size. That's not -- not meant to mean that they're related. And then there's the total of about 500 million. That total is then divided by one point-five (1.5), essentially bringing it down to the one hundred percent ratio.

So it might be a more fair interpretation to say that 70 million divided by one point-five (1.5) would be more reflective of what's in the hundred percent MCT number, just to -- just to be fair. But -- but yes, there is a operational risk margin.

DR. BYRON WILLIAMS: And as we move along to the right, we see the operational risk margin ranging from 64.6 million to 77.3 million, recognizing your proviso of a divide by one point-five (1.5)?

MR. LUKE JOHNSTON: That's right.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Okay. Mr. Johnston, were you with the Corporation way back in -- in 2000?

MR. LUKE JOHNSTON: Perhaps as a student. I am -- I may have been working in -- in the States at that time, but full time, I think 2001, but as a student before that, so not a -- not a full-time employee.

DR. BYRON WILLIAMS: Okay. And if we could pull up Board Order 151 of 2000, and go to page 15 for a second. And Mr. Johnston, you had a bit of this discussion I think with Mr. Oakes this morning, but you'll agree with me generally that back in the 19 -- late 1990s, in terms -- in supporting the Manitoba Public Insurance Rate Stabilization Reserve target, the Corporation was proposing a statistical variance approach, considering a number of different risk factors. Do you recall that, sir?

MR. LUKE JOHNSTON: Yeah. In my recollection, this is one (1) of the early attempts to use a risk base targets instead of a percentage of premium targets.

DR. BYRON WILLIAMS: And sir, just directing your attention to page 16, the second -- the first full paragraph, actually, and starting at lines

-- line 4 and 5, you see reference to earlier Board Orders been 154/'98 and 177/'99 presented as -- the Board -- raising -- stating that the inclusion of all operating expenses was inappropriate, at least as they were partially con -- as -- as these were at least partially controllable by management.

Do you see that analysis, sir?

MR. LUKE JOHNSTON: I do. And -- and just -- I don't know if this is the parallel that you're drawing, but I -- so I don't want to assume that, but when we talk about operational risk in the -- in the MCT test, for example, I don't think we're talking about the -- the risk of variation in your operating expenses. I don't think companies have, you know, the -- we can control our FTEs, and things like that, probably more so on the projects and the impacts of those projects when they don't work out as -- as planned.

So I -- I understand this point, but at that time, the -- the volatility and operating expenses themselves was excluded from the -- the risk analysis.

DR. BYRON WILLIAMS: So the -- as the MCT contemplates it, sir, operational risk is associated with a failed information technology program? Would that be contemplated?

MR. LUKE JOHNSTON: At my fingertips, I don't recall everything included in there as described by OSFI. But my understanding is it would be for things like -- of that nature.

DR. BYRON WILLIAMS: So subject to check, sir, aspects like the failed customer claims reporting system, CCRS, might be contemplated by MCT and operational risk?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: All -- I think what OSFI's doing in the test is recognizing that all insurance companies have operational risk, and not recognizing it would be inappropriate in terms of assessing the risk of those companies. But there are, of course, examples at MPI where projects have -- have not turned out, and the example you gave is -- is one (1) of them where it did not -- did not turn out as planned.

DR. BYRON WILLIAMS: And arguably, sir -- well, we'll get to that next week.

In terms of a target confidence level, am I correct in suggesting to you that OSFI is elected

99 percent of the expected shortfall over a one (1) year time horizon as a target confidence level?

MR. LUKE JOHNSTON: That's correct.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: And just the last couple of questions. Manitoba Public Insurance recalls that there was a technical conference in terms of the Capital Maintenance Provision and whether or not it should be incorporated into the rate-making process?

MR. LUKE JOHNSTON: I do recall the technical conference, yes.

DR. BYRON WILLIAMS: Using the word 'consensus' to include the perspective of Intervenors, PUB advisors, and Manitoba Public Insurance, would Manitoba Public Insurance suggest that there was consensus on the requirement for a capital maintenance provision flowing from that dialogue?

MR. STEVE SCARFONE: I just -- I want to interject, Mr. Williams. The materials filed by MPIC have MPIC stating its position as from the Corporation's viewpoint. There may have been a consensus reached on CMP. But having said that, there is an issue squarely before the Public Utilities Board on the Capital Maintenance Provision. So to the extent that you're going to suggest there was no consensus, MPIC will concede that your client is not in agreement with the Capital Maintenance Provision.

MR. LUKE JOHNSTON: If -- if I -- if I could add, I -- the -- MPI's brought its proposal for a capital maintenance provision. We don't -- we haven't pretended that CAC agreed to the -- our proposal, but the fact that there was a technical conference on the topic and the need to discuss it, I think -- I think we'd all agree that -- that was, I would hope, agreed to by CAC that that conference should be had, and -- but we don't assume that CAC agrees with our proposal, necessarily.

DR. BYRON WILLIAMS: We thank MPI for that. And just to be clear, MPI is not suggesting flowing from that technical conference was consensus on the requirement?

MR. STEVE SCARFONE: Sorry, could you say that again, Mr. Williams?

DR. BYRON WILLIAMS: MPI is not suggesting that flowing from that technical conference was consensus on the requirement for a capital maintenance provision?

MR. STEVE SCARFONE: No. We understand that it's something that the Corporation is seeking in this application, and to the extent that there may be some opposition to its requirement, then I agree.

DR. BYRON WILLIAMS: Okay. Just if -- if I could just check with my clients, Mr. Chair, members of the panel.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: I told counsel for the Board that I would try and be done by 3:30. For the record, it's 3:32, so I apologize sincerely for my failures, among many. But thank you, MPI panel. And subject to the undertakings which exist -- I think exclusively relating to Mercers and asset liabilities, that closes our cross-examination of this panel.

THE CHAIRPERSON: Thank you. I'll ask the panel if they have any questions. M-hm.

Okay. I -- I have a few questions. Kristen, we had the chart we talked about yesterday, I can't remember, Exhibit 1. There's the -- I'm sorry, not -- there was the other one that showed the --

there was reference to the fact that BC and SGI had the MCT 100. I don't know what table that is. It doesn't really matter. Sorry?

MR. LUKE JOHNSTON: That would -- I think you're referencing the -- our opening presentation graph from MPI. Is that...

THE CHAIRPERSON: That one, yes. Sorry. In terms of this slide, Mr. Johnston, I take it you would agree that there are different factors in different jurisdictions?

MR. LUKE JOHNSTON: Absolutely.

THE CHAIRPERSON: And that each jurisdiction is looking for certainty and stability in it's in -- in -- in rates and financial stability?

MR. LUKE JOHNSTON: Agreed.

THE CHAIRPERSON: So when I look at this in terms of ICBC having an MCT 100, that's simply one (1) factor that may relate to the characteristics of the situation in BC.

MR. LUKE JOHNSTON: I think all we're stating here is that all the other public insurers have at least moved to this as a basis for their target. How they got there specifically, I don't know all the details, some of it's likely confidential.

The -- the -- the hundred percent MCT

itself, it does have the benefit stated on here that it is not subject to the same influences that maybe our methodology is subject to, right.

So there's a lot of the assumption making and best estimates and -- and should inflation be in or out, right, which can lead to very -- as you know, very long discussions here and all kinds of models and stuff being built.

And at least in recent years it's created quite a bit of volatility in some of the targets. We don't want that either.

THE CHAIRPERSON: Right. But, for example, B.C. is a tort province.

MR. LUKE JOHNSTON: Yes.

THE CHAIRPERSON: The risk factors may be higher in a tort province versus a non-tort province.

MR. LUKE JOHNSTON: I agree with that, but I will say that, as I mentioned earlier, most of the risk factors, particular with assets, if we hold less risky assets we'll have a lower dollar number.

And then, in terms of the claims, the liabilities that we hold, I would characterize MPI's as some of the most risky that -- in the industry, just because of the length and we talked about forty

(40) years of payments and the -- the -- you know, the likelihood of being right on that is -- is low, is very risky.

So ICBC I would say has more of a short-term forecasting risk in the sense that MPI's coverages and product is clearly defined. We have no fault injury benefits. The escalate -- the rapid escalation of severity on the injury side isn't -- doesn't exist in as great an extent as it would in B.C.

So, in terms of that risk I would say ours is definitely lower. That's one (1) of the benefits of the program. But we're looking more -- I would call that -- that pricing risk for -- for ICBC, as opposed to what's on the balance sheet.

MR. MARK GIESBRECHT: If I can just add to that and emphasize some of the points that Mr. Johnson raised.

While the tort system exists in B.C., which typically you would expect could lead to additional costs in the settlement of claims, what it does allow for the insurance companies there is to settle those claims and not carry long-term liabilities, which we have due to our PIPP program here in Manitoba.

So while we hope and we expect that we will have lower overall costs, which will allow us to deliver better value to Manitobans, the fact does remain that we do have long-term liabilities which does result in -- in that reserving risk, which is really the focus of our whole ALM program, to ensure that we have adequate funds in the proper matching of those liabilities.

THE CHAIRPERSON: Have either of you two (2) gentlemen spoken to people at ICBC in the past year?

MR. MARK GIESBRECHT: I have not.

THE CHAIRPERSON: Okay.

MR. LUKE JOHNSTON: I have had some conversations with -- it's Bill Carpenter, nothing in great depth, but obviously we had to share some data, but not in terms of, you know, how they count -- what their capital requirement or things like that.

THE CHAIRPERSON: Mr. Johnston, do you know the financial position of ICBC versus MPI at this time?

MR. LUKE JOHNSTON: In detail, no, but ICBC not -- apparently not very good position, yes.

THE CHAIRPERSON: Do you know what the current rate request is to the BC Utilities

Commission?

MR. LUKE JOHNSTON: My understanding, it's large. And -- and just to be clear, MPI is not, you know, through this graph objecting to any of the regulatory processes or design we have in this province. We think that we have a great product and a -- and a great regulatory process, right.

So we definitely are not wanting a tort environment or, you know, a hearing every four (4) years, like SGI or something like that. There's a lot of significant benefits here -- here in Manitoba, and that's likely why we have some of the lowest rates and most stable rates, at least, on -- on average.

We're -- we're really just focusing on what's the right capital so we can -- to us that's one of the remaining pieces to really make this a strong public insurance program.

THE CHAIRPERSON: Thank you. Those are my questions. I'm just wondering if we have any update on what the next step is in terms of the next panel and when we will start.

Mr. Scarfone...?

MR. STEVE SCARFONE: I understand that the next panel is ready to present beginning tomorrow morning at 9:00 a.m.

And -- but I do have a couple of questions on redirect, Mr. Chairperson, if the ---

THE CHAIRPERSON: Yes, I'm sorry, Mr. Scarfone, that was negligent on my part. Please, go ahead.

MR. STEVE SCARFONE: So then my expectation is after the redirect we would reconvene tomorrow with the next panel.

THE CHAIRPERSON: Good, thank you. Yes. Please proceed.

CONTINUED RE-DIRECT EXAMINATION BY MR. STEVE SCARFONE:

MR. STEVE SCARFONE: Thank you. And it's just a couple of questions, Mr. Johnston.

Mr. Johnston, you may recall counsel for the Public Utilities Board, Ms. McCandless, was asking some questions this morning concerning the rate stabilization reserve and a rebuild provision for the reserve, as compared against the -- the proposed capital maintenance provision.

Do you recall those questions?

MR. LUKE JOHNSTON: In general, yes.

MR. STEVE SCARFONE: Okay, so a couple of follow-up questions on that, Mr. Johnston.

Would a rebuilding fee, and just to be

clear, MPIC, are they requesting a rebuilding fee for the RSR in this year's application?

MR. LUKE JOHNSTON: We're not requesting a capital maintenance fee, but I understand that other parties may see that as rebuilding. But that -- based on how we've define -- defined it, we're simply maintaining our capitalization, not rebuilding -- or not making it stronger.

MR. STEVE SCARFONE: Yes, and so that was my question. With the rebuild provision, if -- if adopted, would that prevent a decrease in the MCT percentage that the capital maintenance provision is designed to do?

MR. LUKE JOHNSTON: Just making sure I understand. So, capital maintenance would just keep the MCT level the same. A rebuild would make the MCT ratio increase. So we're not asking for that. We're asking just to keep it the same.

Was that your question?

MR. STEVE SCARFONE: Well, it kind of does. But if -- if there was a rebuild provision incorporated into the rate application, it could still be that the capital position, as it concerns MCT, could fall from fiscal year 2018/'19 to 2019/'20.

Maybe this is an easier way to approach

it.

Could you, following up on the questions of Ms. McCandless, explain the difference between a capital maintenance provision and a rebuilding fee for the RSR?

MR. LUKE JOHNSTON: Okay, so capital maintenance, again, we've -- we've used the MCT as the basis for determining maintenance. We think that's appropriate.

So, for the capital maintenance we're saying, again, that how -- the capital position that the policyholders come into the year with should be the same when they leave that policy year. And we do that by maintaining the MCT at the same level.

If we went into a situation where the Corporation had just suffered major losses, and so let's hypothetical say the -- the MCT ratio had fallen to 10 percent, step 1 would be to figure out the capital maintenance provision to keep the MCT at 10 percent and then step 2 would be to look at the capital management plan to decide how quickly and by how much we would want to rebuild capital per the rules of that -- of that plan.

So, if our lower target was 30 percent, we might have a rule that we want to get there 1/5 of the time, to the lower or to the middle or something like that. We -- we haven't come forward, to PUB with those rules yet, but that would be -- that would be the idea.

MR. STEVE SCARFONE: Okay. Thank you. So I think -- I think you answered my question in that a rebuild provision, if I understand it, would increase the amount that's been held in reserve.

MR. LUKE JOHNSTON: It would -- the rebuild would -- the intent would be to increase the amount in dollar terms and the MCT ratio.

MR. STEVE SCARFONE: Thank you. Can we have pro forma 3 pulled up again, please. Thank you.

I understand from your evidence this morning, again in response to some questions for Ms. McCandless, Mr. Johnston, that at the bottom of that graphic we see the MCT ratio staying the same beginning 2019 forecast.

Do you see that, sir?

MR. LUKE JOHNSTON: I do.

MR. STEVEN SCARFONE: Could you explain what you meant by the inclusion of a 2.1 percent capital maintenance provision into those projections? Is that a one (1) time -- is that a one

(1) time inclusion?

MR. LUKE JOHNSTON: Yes. So, if -- if approved the rates will have the 2.1 percent provision built into that rate.

The -- if those rates -- what we're saying here, if those rates were to stay in -- in force, we would not expect to ask for any additional amount, but we would still report to the Board that -- that there is, in fact, the 2.1 percent provision in the rate, to make -- so that everyone is aware of that. But no -- at this time no additional amount is being implied by this forecast over the forecast period.

MR. STEVE SCARFONE: Okay, thank you. And next, Kristen, if you can pull up the -- the Board Order from June, which was the compliance Order that Ms. McCandless asked questions of Mr. Johnston on.

(BRIEF PAUSE)

MR. STEVE SCARFONE: Thank you. If you can scroll down to the -- the -- the -- the issues list please. Thank you, right there.

Mr. Johnston, do you recall the questions put to you concerning the financial forecast in the justification of the naive methodology being used this year?

MR. LUKE JOHNSTON: In general, yes.

MR. STEVE SCARFONE: Yes. Sir, in the Corporation's estimation is the use of the naive forecast for the 2019 GRA a best estimate?

MR. LUKE JOHNSTON: In my opinion and the Corporation's, it is.

MR. STEVE SCARFONE: And last year, sir, you will agree that the Corporation again used -- made use of the naive forecast in its forecasting?

MR. LUKE JOHNSTON: Yes, it did. And just -- just to clarify my original response. There were -- the nave forecast made at this time was our best estimate. When thing -- things happen over the next six (6) months, it's hard for me, I can't say, you know, the best estimate I made six (6) months ago was the same.

So we have new information. But we're suggesting to use that information and maintain a naive forecast as a best estimate. But if you asked me on February 28, 2018 if this was my best estimate, it would be, yes.

MR. STEVE SCARFONE: Thank you. And for the 2018 General Rate Application, Mr. Johnston, do you recall if the use of the naive forecast was your best estimate?

MR. LUKE JOHNSTON: Yes, it was.

MR. STEVE SCARFONE: And that, sir, would have been a departure from the 2017 GRA, when MPIC took the position that the 50-50 forecast was the best estimate. Is that -- is that fair?

MR. LUKE JOHNSTON: That's correct. And just to be very clear here, MPI is struggling with this issue just as much as everyone else in the room.

As I mentioned on -- I don't know if it was yesterday, the higher interest rates mean -- likely mean rate decreases for us and the -- that obviously would be a good result for MPI, government, et cetera. We would all like interest rates to rise, but we've seen, you know, the consequences of making those kind of bold assumptions.

In some of those earlier years, when interest rates were just on the downturn for, kind of in these unprecedented territory, MPI was trying to find a balance between, you know, rapid mean reversion and increases versus the enormous amount of risk that -- the pricing risk that would occur if you were to use those assumptions.

So we've all seen how that as turned

out now, and again, we continue to try to find ways to minimize that risk as much as possible.

Compliance filing was one (1) of the ideas put forward. But at least in terms of the recent history, it's hard to justify using the bank's forecast as a -- as a best estimate. Naive has performed the best in -- in all of the comparisons that I've seen.

MR. MARK GIESBRECHT: If I could just elaborate and add to that response as well.

We know over the past number of years that we've had a lot of assumptions made on interest rates, and together the people in this room have done their best to, you know, estimate what those -- those changes will be. And what we've seen based on experience has -- we had banked on rising interest rates. We essentially swung from the fences and we struck out.

And what that meant was serious losses for the Basic line of business. And if not for available funds and other non-Basic lines of bus -- lines of business, it would have meant significant rate increases for ratepayers.

So I think a valid way or another way of looking at the decision around interest rate forecasting is -- or put it -- put it this way, we have heard a lot about economic experts and all -- all these different terminologies and fancy terms that get thrown around.

The one (1) thing that is clear is that nobody can tell the future with any kind of consistency or with any kind of accuracy. And I think one (1) way to look at it may be: What is the outcome?

And so the outcome of banking on interest rates rising and not getting it right means that we are going to have a shortfall and we would have to go back to ratepayers in subsequent years and say, we need a rate increase because we didn't have the rates we thought materialized.

Alternatively, if we let rates materialize, and rates do rise, we can go back to ratepayers and -- and tell them you will have a -- a rate decrease.

And so, our position is that we do not want to go to ratepayers and ask for a significant increase. We would rather be in a position to allow a decrease.

THE CHAIRPERSON: If I could just ask Mr. Giesbrecht. Mr. Giesbrecht, it sounds like the test is being changed from best estimate to least downside.

Would that be a fair comment? Best estimate connotes, here's the best estimate of what we think is going to happen based on rates rising, and least downside is, if we're really conservative, essentially, we -- we've got it -- and rates go up we haven't -- we've got the upside. We don't have much of a down -- we've reduced -- we've reduced our downside.

MR. MARK GIESBRECHT: Yes. I -- I can't speak to prior years and what was determined as a best estimate. Looking at the data and the support that we have, I think it's clear that a non-biased, naive forecast in the -- the -- the recent years is clearly the best estimate.

However, I agree with you. From -- from my perspective, it makes sense that you want to temper that with conservatism with the intent of managing stable and predictable rates.

MR. LUKE JOHNSTON: Just -- just some history here. I'm getting to be the old guy here.

The -- yeah -- so Ms. Reichert started here, I believe six (6) years ago, give or take. And one (1) of the big, initial tasks that -- that she had was to build a new financial model, and that was one (1) of the things that the Public Utility Board also wanted to see for DCAT modeling and scenario testing.

One (1) of the big pieces of that was putting in modeling of interest rates and prior to that, every forecast MPI had ever made was naive interest rates, because we didn't even have the capability to do the modeling of liabilities and bonds, like right. So we would put in the forecasted new yields -- of -- of new money that we invested in. But the liabilities and assets themselves did not change.

When we put that functionality in, all of a sudden there -- you know, and we went into this weird interest rate environment, all of a sudden you saw these dramatic swings in the financial statements created by the interest rates, which is good information to have.

But at the same time, it -- especially in the low interest rate environment, it showed everybody here, well, that 3 percent rate increase all of a sudden is zero if we just use the bank forecast and all is good, right?

And I think that's got us into a little bit of -- of trouble, doing that. I can tell you that the period of time when we weren't doing that, we enjoyed quite a long stretch of almost no rate changes or any, you know, significant amounts. We had about a fifteen (15) or sixteen (16) year stretch where we had one -- one (1) rate increase, not that the two (2) are perfectly correlated, but I believe is was a much safer assumption than making what are really pretty big bets in some of those bank forecasts.

They -- we were talking 200 plus basis points in some of those bank forecasts a few years ago. That's a pretty big -- pretty big bet.

CONTINUED BY MR. STAVE SCARFONE:

MR. STEVE SCARFONE: Thank you. Just one (1) more question for you, Mr. Johnston, then I have a couple questions for Mr. Bunston on investments and I think we're done, subject to my co-counsel's comments.

Kristen, if we could have put on the screen the -- the benchmarking comparisons in the investment returns. I think it's PUB-186, Information Request from the -- from the Board.

(BRIEF PAUSE)

MR. STEVE SCARFONE: Keep going down. No, I apologize. So this is on the efficient frontiers. But I can just, without pulling up the document and following up on Mr. Chairperson's comments about the uniqueness of the jurisdictions that have public auto insurer, Mr. Johnston, can you make any comments to the extent that SGI shows better returns than MPIC does in its investment portfolio, what, if any -- what if anything might contribute, in your view, to the difference that can be seen in those investment returns?

MR. LUKE JOHNSTON: Not professing to be an expert on SGI, but in terms of the matching of -- they're very similar in that they have a lot of long-term claim liabilities.

They use a -- a bucketing -- fixed income bucketing approach based on the -- the timing of the cash flows for the first twenty (20) years, and then beyond twenty (20) years the liabilities are matched to growth assets.

Obviously, growth assets are going to have a higher long, long run return, but also are going to have more risk. So, if MPI had followed such -- such an approach as that for this ALM study, you would've seen probably an opposite effect as the one I described earlier in terms of the capital targets. A hundred percent MCT amount would've went up, but our return would've also increased.

So we would have probably came here and said that, okay, the rate indication is a little bit lower than we're asking for, but we need a bigger RSR.

Our direction from our Board and the government is that volatility is not -- we're not seeking greater volatility. So that's -- type of strategy wouldn't be pursued.

The other major concern that I'm sure SGI has with their strategy is this idea of matching equities to their claim liabilities. It's going to be somewhat of a concern when we flip over to IFRS. We don't know the exact mechanics of that yet, but if they're required to use a -- a discount rate based on a -- kind of a hypothetical bond portfolio, their liabilities are going to have to go up in value. The valuation on those is going to increase substantially, so that -- or at least that would be my expectation.

So we will not have that issue, because we're essentially already matched to the bonds. We might get a little bit of a hit, but anyways, does that answer your question?

MR. MARK GIESBRECHT: I'll just --

MR. LUKE JOHNSTON: Yeah.

MR. MARK GIESBRECHT: -- I'll just add quickly, if I could. When comparing against SGI, it's important to consider that we do have a different risk tolerance, and it was -- we'll walk through a number of Board Orders about interest rate risk management. And so SGI has taken a different approach where they match a -- a portion of their liabilities with equities, which would have a different effect in terms of interest rate risk management.

And so, given the approach in Manitoba in our risk tolerance, it's not a fair comparison to look at the peer portfolio returns without doing a -- a -- an adjustment that we have provided terms of re-weighting the portfolio to see if we had the same risk appetite, and same tolerance, then it's a fair comparison.

But just the -- the topline returns, given the -- the composition of their portfolio, is not a fair comparison, given our approach to interest rate risk management.

MR. LUKE JOHNSTON: I'm -- I'm just -- I -- I can tell you internally, and Mr. Bunston can attest to this, our Board wants no interest rate deviations of any kind, so we report every single month the impact of the asset liability matching. If we are out by even a few million, we would explain every change in great detail. The goal is for that -- that zero all the time, and to have a -- it hasn't always been, but we're continuing to get, I guess, pushed by our Board to do everything we can to neutralize that risk to as close to zero as possible.

MR. STEVE SCARFONE: Thank you, gentlemen, and I -- I appreciate we're running close on time, here, but one (1) follow-up question to that, then, gentlemen.

Can you explain why it is that a -- a corporation that is better capitalized then a -- a -- another would be in a better position to invest in growth assets to obtain better yields?

MR. LUKE JOHNSTON: Well, I guess step -- step 1 of that is -- is actually really just a mathematical exercise. And what I mean by that is, if MPI had more money in the RSR, we would invest -- automatically invest more in growth assets in the segmented portfolio, because that portfolio has grow -- a percentage of growth assets. So we'd automatically have a higher allocation to -- to the stock market.

But obviously, if a company has --

right or wrong, if a company has a lower MCT target, say, of 30 percent, and they're operating around that range, I would expect that they would have to be more cautious than a company with a hundred percent MCT. I don't see how you can draw that -- that parallel.

The -- the implications of even minor -- not -- we're not even talking about 1:40 deviations, just bad winters, you know, change in interest rates, and all of a sudden, as you've seen by some of our results, you could lose 50 or $60 million, no problem. You're immediately into asking ratepayers for rebuilding fees, and -- and things like that.

Our -- so -- so our -- our recent experience and our -- and our capital levels obviously drive our risk appetite decisions. I'm not saying that that's -- that's wrong, but hopefully, the Board can appreciate why MPI has a lower risk appetite, based on all the, you know, every -- considering everything in -- in its -- in the environment it operates.

MR. GLENN BUNSTON: Maybe I could just add to that. You know, I mean, obviously, growth assets are more volatile than fixed-income assets. So equities, real estate, and infrastructure in -- in our case, which we defined as growth assets, and so the --

the downside is much larger, when you invest in growth assets. And so you would require a larger capital reserve to protect you from the -- the downside scenario when you have significant allocation of growth assets.

So the reserves do matter, and you need reserves -- significant reserves to protect you from the downside that is associated with investing in those more volatile asset classes.

MR. STEVE SCARFONE: Thank you, Mr. Bunston. So one (1) quick question for you, Mr. Bunston.

Kristen, if we can have the invest -- the Appendix 17 from the investments chapter, Attachment B, slide 21, please.

(BRIEF PAUSE)

MR. STEVE SCARFONE: Thank you. Mr. Bunston, we heard Mr. Makarchuk describe these portfolios, Basic 1, Basic 2, 3, and 4 as what he described as the -- as the front runners. You'll -- you'll note...

(BRIEF PAUSE)

MR. STEVE SCARFONE: Yes. That's fine. Yes. Perhaps scroll down -- or scroll up one (1) page. There we go. Thank you.

We know that MPIC selected the Basic 3. Mr. Bunston, are you able to -- to just provide some insight into why that particular portfolio was selected over Basic 4, which it seems also have some favourable characteristics?

MR. GLENN BUNSTON: Yes, I can. So yesterday, when we talked about this, we talked about Basic 3 relative to Basic 4, the different -- the major difference being that Basic 4 has a -- an allocation of private debt, while Basic 3 does not.

The strategy -- the interest rate risk management strategy for our Basic claims portfolio was duration management and duration matching of our fixed-income portfolio relative to our claims liabilities, and including an allocation of private debt would complicate that duration matching strategy in that the -- the duration of the private debt is -- is harder to control and harder to predict with the precision that we would need.

So there was that factor, and then secondly, yesterday we -- we looked at the risk and return metrics for Basic 3 relative to Basic 4. And I

-- the -- the one (1) comparison that we didn't talk about yesterday was comparing Basic 3 relative to the current mix. And there was question about the -- the risk associated with Basic 3, and whether that was acceptable.

We looked at the -- the 97.5 percent VaR, or value at risk measure, for Basic 3, which is $45 million, which means that we could lose $45 million in -- in one (1) year, with 97.5 percent confidence. But for the current portfolio, the -- the value at risk number was $147 million. So, yes, the $45 million -- the VaR risk estimate for Basic 3 is acceptable to us. It is a significant reduction of over a hundred million dollars from the current portfolio.

So it's not as low as Basic 4, but there were reasons that we did not want to invest in private debt, and so that's why we did not select Basic 4.

MR. STEVE SCARFONE: Thank you, Mr. Bunston. And Mr. Guerra, I understand you have one (1) or two (2) questions.

RE-DIRECT EXAMINATION BY MR. ANTHONY GUERRA:

MR. ANTHONY GUERRA: Yes. Thank you.

I just have a couple of questions. The first one relates to comparisons between MPI and SGI. We've heard some discussion today and earlier about SGI's use of a capital maintenance provision, and whether or not the -- the style of capital maintenance provision used by SGI is -- is appropriate for -- for use by MPI.

And I'd like further clarification on -- on MPI's position as to why MPI's own CMP is preferred over the SGI model.

MR. LUKE JOHNSTON: Yeah. So -- so our main -- what we see as the main benefit of -- of the MPI model is that it just focuses on the -- the one (1) year, and what is needed to maintain capital in that one (1) -- in one (1) -- that one (1) fiscal policy year, I guess we can call it. That, in our view, makes sense in terms of what's a fair contribution to capital maintenance for a group of policyholders.

If we start looking at the five (5) year forecast period, there are some questions on, you know, what if your risk profile changes, and -- or if there's things in the forecast that could cause swings up and down. To -- in -- in my view, that would be more difficult to normalize over a five (5) year outlook period than it would be to understand the most recent year that you're going in, and at least providing evidence here that the Cap -- Capital Maintenance Provision for that particular fiscal year is approp -- is appropriate.

So not to say the SGI model is -- is bad. I think they're trying to maybe smooth out some of the volatility in it, but we -- we think the focus should be on the -- the test year for -- for that maintenance provision.

MR. ANTHONY GUERRA: Thank you. And one (1) further question. You were asked from the panel this afternoon about comparing the need for a 100 percent MC -- sorry, MCT ratio. There was reference made to the other public insurers, and some private insurers, suggesting that they all have at least 100 percent MCT ratios.

But my understanding, correct me if I'm wrong, is MPI isn't asking for a -- a hundred percent MCT ratio in this year's GRA. Is that correct?

MR. LUKE JOHNSTON: That's correct. The -- we're really just trying to get the -- the idea across, here, that some of these comments, or even reading the newspaper, suggests that MPI is taking people's money away and doing unreasonable things to the public.

We consider our capital targets to be on the lower end, but by no means do we consider them excessive in -- in any way. So we've applied for the -- what equates to about a 35 percent to 85 percent range. That's -- that -- that is what we applied for. We want to maintain within that range.

But this characterization that, you know, MPI's asking for, you know, too much in its rainy day fund, or anything like that, really doesn't check out with a comparison to really any other insurer in the world. We would continue to be on the low end, based on that -- the methodology that -- that we've collaboratively developed, here.

MR. ANTHONY GUERRA: Okay. Thank you. Those are my questions.

THE CHAIRPERSON: Thank you. So we'll adjourn this morning and reconvene at 9:00 -- sorry. We'll adjourn right now and reconvene at 9:00 a.m. tomorrow morning. Thank you.

--- Upon adjourning at 4:11 p.m.

Certified Correct

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Cheryl Lavigne, Ms.