"When You Talk - We Listen!"

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

Winnipeg, Manitoba

October 30, 2018

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1 APPEARANCES

2

| | | |
|---|---|---|
| 3 | Kathleen McCandless | )Board Counsel |
| 4 | Robert Watchman | )Board Counsel |
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| 6 | Steven Scarfone | )Manitoba Public |
| 7 | Anthony Guerra | )Insurance |
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| 11 | | |
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| 13 | | |
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| CAC-29 | Excerpt from the Ontario Teachers Pension Plan Annual Report the eleven (11) year financial review just one (1) page, being page 95 and then from the Ontario Pension Plan's website an excerpt relating to the performance of its Pension Plan, pages 1 and 2 of that. | 1662 |
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1 --- Upon Commencing at 9:06 a.m.
2
3 THE CHAIRPERSON: Good morning,
4 everyone. Ms. McCandless, would you like to take us
5 through today.
6 MS. KATHLEEN MCCANDLESS: Yes, good
7 morning. Thank you, Mr. Chair and members of the
8 panel.
9 This morning we're going to complete
10 the cross-examination of Mr. Viola and Mr. Watchmen
11 will be conducting the cross-examination on behalf of
12 the Board.
13 We will then move into a CSI portion of
14 Mr. Viola's evidence followed by closing submissions.
15 So, I will proceed with my closing submission before
16 lunch. We will break for lunch and then at around one
17 o'clock MPI will return to give their closing
18 submission. Thank you.
19 THE CHAIRPERSON: Thank you. Mr.
20 Watchmen...?
21 MR. ROBERT WATCHMAN: Thank you, Mr.
22 Chair.
23
24 RESUMED:
25 CAC WITNESS PANEL 2

1 VALTER VIOLA, Affirm
2
3 CROSS-EXAMINATION BY MR. ROBERT WATCHMAN:
4 MR. ROBERT WATCHMAN: Good morning,
5 Mr. Viola.
6 MR. VALTER VIOLA: Good morning.
7 MR. ROBERT WATCHMAN: Now, I just am
8 going to go through a number of the exhibits and I'm
9 going to refer primarily to the written materials that
10 were filed earlier, namely, your report that was -- is
11 entered as exhibits -- I'm going to refer to revert --
12 revis -- revision number 2, which is CAC Exhibit 11-2,
13 and some of the Information Requests that you
14 responded to.
15 But if there's any difference between
16 those references, and anything that was provided in
17 your presentation yesterday, feel free to refer to
18 that as well.
19 I'm going to start Exhibit CAC-11-2 on
20 page 6, where you set out an executive summary of your
21 recommend -- of your eight (8) recommendations. And I
22 want to start with the first recommendation concerning
23 the real liability benchmark.
24 MR. VALTER VIOLA: Okay.
25 MR. ROBERT WATCHMAN: And your

1 recommendation is for re -- to re-examine the reliance
2 on the nominal liability benchmark rather than a real
3 liability benchmark, given the understatement of the
4 long-term risk of inflation and changing real interest
5 rates that are inherent in the Basic and pension
6 liabilities.
7 Correct?
8 MR. VALTER VIOLA: Yes.
9 MR. ROBERT WATCHMAN: And I want to
10 focus on the issue of inflation, long-term inflation,
11 and in particular, the distinction that has been made
12 in these proceedings concerning the expected level of
13 inflation over the outlook period and inflation
14 volatility.
15 MR. VALTER VIOLA: Okay.
16 MR. ROBERT WATCHMAN: And it's my
17 understanding that if we look at -- actually Slide 12
18 of your presentation yesterday, Exhibit 28 -- sorry,
19 CAC-28, and this is where you noted the distinction
20 between the expected level of inflation and volatility
21 of inflation, correct?
22 MR. VALTER VIOLA: Yes.
23 MR. ROBERT WATCHMAN: And I take it
24 your view is that MPI is exposed to inflation vol --
25 volatility risk, is that correct?

1 MR. VALTER VIOLA: Correct.
2 MR. ROBERT WATCHMAN: And that the
3 proposed Basic and pension portfolios provide little
4 or no protection from inflation volatility?
5 MR. VALTER VIOLA: That's correct.
6 MR. ROBERT WATCHMAN: And effectively
7 what MPI has assumed, and Mercer used in its
8 modelling, is effectively 0 percent inflation
9 volatility over the outlook period?
10 MR. VALTER VIOLA: If I could just
11 clarify that. It's -- I found it a little confusing
12 the way they wrote it because when you look at the
13 Mercer capital market assumptions -- I'm not sure if
14 it's easy to pull that up anywhere -- but they
15 specifically put inflation assumptions in a box up in
16 the right -- in the middle panel and what they say is
17 inflation is assumed to be 2 percent.
18 MR. ROBERT WATCHMAN: Yes.
19 MR. VALTER VIOLA: And in both the
20 nominal liability benchmark portfolio and the real
21 liability benchmark portfolio, when they actually do
22 the modelling, I think the inflation assumption is
23 that they have -- I'm assuming this is the case --
24 that they have a 2 percent inflation assumption
25 embedded in all of the returns, including equities, et

1 cetera.
2 So under both situations where they're
3 measuring -- you're quantifying the efficient
4 frontiers, it is my understanding that both scenarios
5 have a 2 percent level in that, and that the capital
6 market assumptions underlying them reflect it all. The
7 difference in the analysis or the outcomes is
8 reflected in the fact that the definition of the
9 liability benchmark portfolios, that characterize the
10 liabilities, are significantly different.
11 So that -- so the frontiers that get
12 printed off under the real versus the nominal are very
13 different because they're measuring risk relative to
14 something in the one (1) case that assumes that
15 nominal bonds rep -- describe the liabilities accurate
16 accurately, whereas the other one includes real return
17 bonds that capture this inflation sensitivity that's
18 embedded in the return profile of all assets.
19 So just to clarify, so.
20 MR. ROBERT WATCHMAN: Okay and -- and
21 without getting too far ahead of myself is -- is that
22 what's referred to as basis risk?
23 MR. VALTER VIOLA: Yes. So the -- so,
24 yes. So the 4.5 percent that Mercer quantified as the
25 basis risk represents, in my opinion, the

1 mismeasurement of the total risk that is being managed
2 by the fund as measured under the scenario that they
3 do versus the scenario that I believe is a more
4 appropriate one in that Mercer offered as one (1)
5 alternative to them as a suggestion of how to measure
6 risk. That's my understanding, yes.
7 MR. ROBERT WATCHMAN: Okay. Again,
8 I'm going to come back to that in just a minute,
9 because in their rebuttal evidence and this is now MPI
10 Exhibit 19 -- sorry, apparently that -- that is
11 actually Exhibit 20. Thank you.
12 Starting at page 20. And if we scroll
13 down to the bottom of the page, under the section --
14 right to the bottom, under the section 4.1, the
15 difference between a nominal liability benchmark and a
16 real liability benchmark.
17 And you will see the submissions that
18 the MPI provided, and at line 16 to 18, it's stated:
19 "A nominal liability benchmark
20 assumes a 2 percent inflation rate
21 that is static throughout the
22 modelling exercise, that is, it
23 assumes no variability in inflation
24 over time."
25 And is "inflation variability" the same

1 thing as in -- in inflation volatility?
2 MR. VALTER VIOLA: Yes. But when I
3 read that I -- I believe that's not a correct --
4 that's MPI's language. And I -- let me read it again.
5 But that's where I was confused, because that's the
6 first time I interpreted the analysis differently. So
7 I believe -- I believe this is MPI's written
8 interpretation which I don't believe is accurate
9 compared to what Mercer actually did. So let me read
10 it again.
11 And that's what I just -- those -- the
12 language that I just described in my prior response
13 that was addressing specifically this.
14 It's my understanding that if I were to
15 rewrite that, I would suggest that the nominal
16 liability benchmark -- I would say instead of
17 describing the inflation behaviour that's in it, I
18 would say the liability benchmark has no real assets
19 in it.
20 And that the real liability benchmark
21 has some -- a significant component of real asset, 66
22 percent in the Basic liability benchmark portfolio and
23 81 percent for pension. So I don't believe those
24 three (3) statements are accurate. But again, I think
25 you should get MPI and Mercer to clarify.

1 MR. ROBERT WATCHMAN: Thank you.
2 MR. VALTER VIOLA: Because there is a
3 statement by Mercer that contradicts that -- that
4 statement about the zero -- no variability inflation
5 rate because I think somewhere they do state -- they
6 clarify that. I found it confusing when I read it. I
7 wasn't sure which one was right.
8 MR. ROBERT WATCHMAN: Okay, thank you
9 for that explanation. If we can turn the page and at
10 lines 3 and 4 it provides:
11 "The degree to which inflation is
12 expected to vary, matters in the
13 selection of a liability benchmark
14 and is the core issue from MPI's
15 perspective."
16 I take it you would agree with that?
17 MR. VALTER VIOLA: I would agree with
18 that.
19 MR. ROBERT WATCHMAN: And then it
20 carries on:
21 "Based on MPI's review of inflation
22 forecasts from the chart -- Canadian
23 chartered banks, Mercer, the Bank of
24 Canada and breakeven inflation rates
25 currently implied by real return bonds,

1 all data indicates that inflation will
2 be approximately 2 percent over the
3 outlook period."
4 MR. VALTER VIOLA: Yeah, and just to
5 be clear that 2 percent refers to the level, not the
6 volatility.
7 MR. ROBERT WATCHMAN: Correct.
8
9 (BRIEF PAUSE)
10
11 DR. BYRON WILLIAMS: Mr. -- Mr. Chair,
12 and excuse me, Mr. Watchman. I -- Mr. Viola may be
13 looking for a -- a response from Mercers that I just
14 want to stand down for second to see if that's the
15 proper response if...
16 THE CHAIRPERSON: Certainly.
17 DR. BYRON WILLIAMS: I'm sorry, Mr.
18 Watchman.
19
20 (BRIEF PAUSE)
21
22 MR. VALTER VIOLA: If I could have a
23 look at MPI Exhibit 38, please? Thank you.
24
25 (BRIEF PAUSE)

1 MR. VALTER VIOLA: Yeah, so it's the
2 very bottom of the page, please.
3 So, I'll read -- I'll read the
4 sentence. It says:
5 "The inflation volatility assumption
6 of 2.6 percent is implicitly related
7 to the capital market volatility
8 assumptions outlined in Appendix 17,
9 Attachment C, page 18 for each asset
10 class. The inflation volatility
11 assumption was not explicitly used
12 in our modeling."
13 And just, if I so -- that last sentence
14 contradicts the -- the statement that we referred to
15 earlier. I would make a point -- anyways, we'll leave
16 it at that. Thank you.
17
18 CONTINUED BY MR. ROBERT WATCHMAN:
19 MR. ROBERT WATCHMAN: If we just
20 scroll down the page a bit wh -- a little bit, too --
21 too much on page 21, see that Section 4.2 is titled
22 MPI Chose to Accept the Threat of Inflation Volatility
23 with good reason.
24 And from there on continuing for --
25 over the next couple of pages you will see that they

1 provide the rationale for what is described as the
2 inflation volatility threat.
3 And I want to go to page 23, lines 7
4 and 8 and again, they say:
5 "All evidence points to the view
6 that inflation will return to
7 approximately 2 percent whether one
8 looks at the markets, the Bank of
9 Canada or the Canadian chartered
10 banks."
11 And so again, I take it your position
12 is th -- that's the level but not the volatility.
13 MR. VALTER VIOLA: Correct.
14
15 (BRIEF PAUSE)
16
17 MR. ROBERT WATCHMAN: And if we scroll
18 down a little bit to lines 13 to 19 and the last
19 portion of that -- that paragraph reads...
20
21 (BRIEF PAUSE)
22
23 MR. VALTER VIOLA: Sorry, the las --
24 line 20.
25 MR. ROBERT WATCHMAN: Correct, yes.

1 I'm going down to line 20. I'm just -- I was going to
2 paraphrase, and -- and their position is that their
3 assumption with respect to the nominal liability
4 benchmark is very reason -- is a very reasonable
5 approach, particularly given the fact that the
6 breakeven inflation rate implied by real return bond
7 prices as of August 2018 was approximately 1.75
8 percent.
9 Do you agree with that statement?
10 MR. VALTER VIOLA: Well, I don't agree
11 with -- I agree with perhaps -- well, I don't disagree
12 with it except for the conclusion. Sorry, it's a --
13 let me just read it. It -- it indicates that the
14 modeling approach is based on the nominal liability
15 benchmark is a very reasonable approach, particularly
16 given the fact that the breakeven inflation rate...
17 Well, again, I think it's inconsistent
18 as far as my understanding of the way they calculate
19 the breakeven inflation rate.
20 If 2 percent is the average expected
21 level of inflation and the breakeven inflation rate
22 was -- is below that, it means that if the bank hits
23 its target and inflation turns out to be 10 -- 2
24 percent, real return bonds look like a good deal
25 because they're beating the 1.75 that makes them

1 breakeven. Anything north of 1.75, according to this,
2 would suggest real return bonds look cheap.
3 MR. ROBERT WATCHMAN: And --
4 MR. VALTER VIOLA: Relative to nominal
5 bonds.
6 MR. ROBERT WATCHMAN: And is that
7 difference the -- between the 2 percent level expected
8 and the 1.75 being the breakeven inflation rate, does
9 that represent volatility?
10 MR. VALTER VIOLA: The -- any
11 difference between a -- a mean and average is
12 volatility, yes. The true measure of volatility is a
13 little more complicated, but it's referring to the
14 variance of the outcomes, yes.
15 MR. ROBERT WATCHMAN: And -- and while
16 --
17 MR. VALTER VIOLA: If I could just
18 make a point. This is a quarter percentage
19 difference. The Bank of Canada saying at 2 percent
20 average.
21 MR. ROBERT WATCHMAN: Yes.
22 MR. VALTER VIOLA: Within a range of 1
23 to 3, that range of 2 percent -- around 2 percent may
24 seem like not a lot and I think I've minimized how
25 small it might be in passing, but it's a big number

1 because of the implications of the change of real
2 rates, given the duration formula.
3 Because we're talking about long
4 horizon liabilities in the case of Basic pension
5 portfolios with an average duration of ten (10),
6 meaning half the cash was roughly -- are beyond a
7 decade.
8 A 1 percent change of inflation be --
9 on average from 2 percent level to up to three (3)
10 would otherwi -- other things equal cause nominal
11 interest rates, bonds, to do poorly because nominal
12 interest rates would go up, other things equal by 1
13 percent and have a 10 percent decline impact on the
14 bond portfolio which is matched to the ten-year
15 duration.
16 In the case of the pension, it's worse.
17 It's a 16 percent adverse outcome, but it doesn't have
18 100 percent dedicated to bonds. So it's less -- it's
19 a bigger impact percentage-wise, but it's got less of
20 a portfolio and fixed income.
21 So I didn't want to minimize the fact
22 that, you know, it sounds like these are small
23 numbers, but over a long horizon they are big numbers.
24 One (1) of the other things I noted in
25 -- in the writing here was over the horizon. The

1 horizon, as I understand it, is fairly short given the
2 ten (10) year and sixteen (16) year duration time
3 horizons that we're talking about on the liability
4 side, these numbers have a bigger impact.
5 So again, getting to the point of
6 predictability of interest rates, these are estimates
7 and they are -- they have a leverage effect because
8 the liabilities are leveraged.
9 MR. ROBERT WATCHMAN: And would it be
10 correct to say that the volatility that we're
11 concerned about is only volatility in which the actual
12 rate of inflation is greater than 2 percent?
13 MR. VALTER VIOLA: It -- it's greater
14 than what's expected -- is -- as priced in fixed
15 income markets, but I think to the extent that the
16 breakeven inflation is 1.75 or the Bank of Canada is
17 2, yeah, it's anything higher than those things
18 realized.
19 MR. ROBERT WATCHMAN: Yes and then the
20 -- sorry, the distinction I was trying to make was
21 that so if -- if the volatility is that inflation is
22 less than 2 percent that actually --
23 MR. VALTER VIOLA: Level or
24 volatility?
25 MR. ROBERT WATCHMAN: Sorry, yes, so

1 that -- that the -- well, the volatility that's
2 created --
3 MR. VALTER VIOLA: Yes.
4 MR. ROBERT WATCHMAN: -- is in --
5 actual inter -- inflation being less than 2 percent.
6 MR. VALTER VIOLA: Right.
7 MR. ROBERT WATCHMAN: Does that not
8 benefit the proposed portfolios for Basic and pension?
9 MR. VALTER VIOLA: Yes. If inflation
10 turns out to be lower than what's expected, let's say
11 it's 1.5 percent, then, and that's a good scenario
12 because we're expecting it to be worse. It turns out
13 to be better and so bonds will do better than -- than
14 expected, nominal bonds, yeah.
15 MR. ROBERT WATCHMAN: And just so I'm
16 clear, so -- so volatility that's, if I can describe
17 it as negative --
18 MR. VALTER VIOLA: Right.
19 MR. ROBERT WATCHMAN: -- is -- is not a
20 concern?
21 MR. VALTER VIOLA: Correct, yeah.
22 MR. ROBERT WATCHMAN: It's only
23 volatility that's a positive --
24 MR. VALTER VIOLA: Right.
25 MR. ROBERT WATCHMAN: -- in terms of

1 inflation.

2 MR. VALTER VIOLA: Right. Inflation

3 higher than the average is -- yes.

4 MR. ROBERT WATCHMAN: Now, you were

5 asked some questions IRs so I'm going to turn to MPI

6 Exhibit 18, which were the MPI Information Requests

7 and responses and I'm going to turn to page 25. This

8 is MPI-CAC-1-11.

9 And you were asked some questions with

10 respect to part (a) and I just have a couple of

11 questions with respect to your response to part (b).

12 It was on page 26.

13 And your response was that:

14 "My comment about the understatement

15 of the long-term interest risk of

16 inflation and changing real interest

17 rates that are inherent in the Basic

18 and Pension liabilities, related

19 specifically to MPI's determination

20 of the constituents of the Basic and

21 Pension liability benchmark

22 portfolios. As such, there is no

23 industry or academic article that I

24 am aware of that addresses my claim

25 about basis risk."

1 And so I wanted to come back to that
2 concept of "basis risk". And in particular basis risk
3 from the perspective of inflation. And so if we could
4 just turn back in that same exhibit to CAC -- sorry,
5 MPI-CAC-1-8. It's on page 17.
6 Now, this relates to lengthening the
7 nominal duration but I want to just put that on the
8 back burner for now and I wanted to focus on the
9 question of inflation.
10 And if we could turn to the next page
11 and your response to re-examining lengthening nominal
12 bond duration. You indicate what basis risk is. It
13 say:
14 "Unless the basis, normal versus
15 real, are the same for assets and
16 liabilities there is a basis risk
17 from using one (1) type of nominal
18 asset to hedge real interest rate
19 risk and inflation risk in the
20 liabilities."
21 And you provide an example and can you
22 just flesh that out for us and -- and again, with
23 respect to the concern about inflation risk.
24 MR. VALTER VIOLA: Sure. Could we
25 just scroll up a little bit so I can see it. So the

1 four (4) examples of the top. Thank you. Let me just
2 take a minute to read it, please.
3
4 (BRIEF PAUSE)
5
6 MR. VALTER VIOLA: Yeah and, in fact,
7 this is the scenario that we'll talk about later. So
8 essentially -- so the basis risk arises -- if you look
9 at the -- in various parts of my presentation I've
10 described the difference between the composition of
11 the liability benchmark portfolios.
12 So the one (1) that was used in the GRA
13 and the AL, asset liability study, assumed a nominal
14 liability benchmark that consisted 100 percent of
15 nominal fixed income assets with a duration of ten
16 (10) years in the case of the Basic, sixteen (16)
17 years in the case of the pension liability.
18 On the other hand, on the heels of the
19 two (2) questions that we asked, Mercer developed an
20 analysis that reflected a different liability
21 benchmark folio that was based on -- that included a
22 significant component of real return bonds.
23 In the case of the Basic pension
24 liability the real return bond component as a proxy
25 for the liabilities represented 66 percent or two

1 thirds (2/3s) of -- of the liability characteristic.
2 In the case of pension, given the
3 longer duration of sixteen (16) versus ten (10) in the
4 case of Basic, the composition of the liability
5 benchmark portfolio had 81 percent real return bonds.
6 So those are very two (2) different
7 benchmark portfolios. If you a -- if you said, okay,
8 Mercer go out and draw us a similar curve, assets and
9 liabilities -- not asset and liability, but relative
10 to those two (2) benchmark portfolios and say, what
11 would the return on risk look like? The quick answer
12 is, there is a basis risk or a measurement risk called
13 tracking error in the industry that is 4.5 percent,
14 which says that -- that's a volatility number. So
15 statistically, it means that two thirds (2/3s) of the
16 time -- well, I won't get into the statistics. It's a
17 big number. It's a big mismeasurement number.
18 And given -- given the long horizon
19 we're talking about, even small differ -- differences
20 and this is not a small one, will have a big long-term
21 impact, given the fact that we're looking out decades,
22 not three (3), four (4), five (5) years.
23 So, in that case, given certain
24 scenarios, if inflation turns out to be higher than
25 average, what will happen -- we'll talk about what

1 happens to T-bills, treasury bills, which have a short
2 duration, real return bonds and nominal bonds.
3 So if inflation turns out to be not 2
4 percent but 3 percent, on average. So that's
5 different, it's more volatile -- not more volatile but
6 it's higher than expected. That 1 percent difference
7 would -- other things equal cause nominal interest
8 rates to rise by 1 percent and nominal bonds to fall
9 by 10 percent in the case of Basic because that's what
10 the portfolio looks like.
11 And -- and 16 percent in the case of --
12 sorry, I shouldn't say that. I'm assuming the -- the
13 pension portfolio is -- has -- has a duration matching
14 policy as well, but let's just focus on Basic.
15 So nominal bonds in the Basic portfolio
16 would do poorly in that environment because bonds will
17 -- bonds will go down and there's -- they're a hundred
18 percent of the portfolio.
19 If, on the other hand, real return
20 bonds were in that portfolio, they would maintain
21 purchasing power. By definition, real return bonds
22 hedge 100 percent of the inflation risk over all time
23 horizons that the bond is outstanding. So, when you
24 buy a real return bond worth a hundred dollars, if
25 inflation turns out to be 3 percent, it's as if you

1 bought a bond worth 103 and the coupon that you agreed
2 to receive would apply to the hundred and three next
3 year, et cetera. So the principal component gets
4 indexed to inflation.
5 So, real return -- return bonds will do
6 well for two (2) reasons. One (1), they're protected
7 against inflation risk so they'll get a higher coupon
8 because it's applying to a higher principal index
9 based to inflation.
10 And, secondly, investors may wake up
11 and say aha, instead of expecting 2 percent now
12 inflation's 3 percent, and therefore, maybe it's time
13 to buy more real return bonds because I think maybe
14 the inflation will be higher. So they would otherwise
15 bid up real return bonds, yields will fall, and that's
16 where the -- that volatility equation of the inflation
17 risk, where inflation -- not inflation risk, but
18 interest rate risk depends on the volatilities between
19 inflation and real rate bonds.
20 So when inflation volatility's higher
21 than normal, it's gone up to 3 from 2, it is the case
22 probably that real yields will fall. So hopefully
23 that elaborates enough.
24 MR. ROBERT WATCHMAN: Thank you.
25 MR. VALTER VIOLA: You're welcome.

1 MR. ROBERT WATCHMAN: Now, I just -- I
2 just wanted to go back to the MPI rebuttal evidence,
3 which is MPI Exhibit 20 and page 24, the bottom half
4 of that page, at 4.2.3.
5 And the subject there is the cost of
6 inflation variability is low. And you will see in the
7 second sentence of the first paragraph, it states:
8 "Given the Bank of Canada's
9 inflation target range of 1 to 3
10 percent, it was assumed that a
11 plausible worst-case scenario for
12 inflation was sustained 3 percent
13 inflation over a four (4) year
14 forecast period."
15 You see that?
16 MR. VALTER VIOLA: I do.
17 MR. ROBERT WATCHMAN: I have a couple
18 questions and -- and first of all, I guess the
19 question is whether you would consider that to be a
20 plausible worst-case scenario?
21 MR. VALTER VIOLA: Worst-case is by
22 definition worst, so, I would not say that's a worst-
23 case. Having said that, they're saying "sustained 3
24 percent," and it's only looking four (4) years. So
25 it's saying, at worst, it will be 3 percent, 3

1 percent, 3 percent, 3 percent. I can think of worse.
2 And in fact -- well, we just had an experience in
3 August that was touching on that. So it's not the
4 worst. It's plausible and it could be a lot worse.
5 And the time horizon is really short.
6 So even if it is the worst one, I'd
7 worry about even a less severe change, but sustained
8 over a longer period than four (4) years.
9 MR. ROBERT WATCHMAN: And -- but just
10 looking at that example in --
11 MR. VALTER VIOLA: Yeah.
12 MR. ROBERT WATCHMAN: -- in terms of
13 the vol -- inflation volatility that we're concerned
14 about --
15 MR. VALTER VIOLA: Yep.
16 MR. ROBERT WATCHMAN: -- so that --
17 that positive volatility from 2 percent to 3 percent,
18 does that effectively represent 100 basis points?
19 MR. VALTER VIOLA: Yes.
20 MR. ROBERT WATCHMAN: And that's the
21 volatility.
22 MR. VALTER VIOLA: Well, I just want
23 to be careful. Volatility is a -- a statistical
24 measure.
25 MR. ROBERT WATCHMAN: Yes, yes.

1 MR. VALTER VIOLA: But that's the
2 change --
3 MR. ROBERT WATCHMAN: But that's the
4 change that would be -- form part of the volatility?
5 MR. VALTER VIOLA: Yes.
6 MR. ROBERT WATCHMAN: And if I could
7 ask you to refer to Slide 27 of your presentation,
8 that's CAC Exhibit 28. Sorry, the next -- the next
9 page 27 -- oh, sorry, Slide 27. The next page. Thank
10 you.
11 And so if we could just -- so under
12 Consumer Price Index is this where we would look for
13 inflation volatility?
14 MR. VALTER VIOLA: Yes. If you look
15 at -- yes.
16 MR. ROBERT WATCHMAN: And so if we
17 compare that 1 percent to the volatility, especially
18 that that's highlighted in yellow under the column
19 Consumer Price Index, we'll see that it's -- 1 percent
20 is greater than the volatility expressed -- or
21 highlighted in yellow under each of the five (5)
22 years, ten (10) years, fifteen (15) years, and twenty-
23 five (25) years, with the one (1) exception being
24 under five (5) year 1998 to 2002.
25 MR. VALTER VIOLA: And we're going to

1 have to be careful, here. That's why I was clarifying
2 my understanding of your use of the term "volatility."
3 So standard deviation -- this table
4 shows standard deviation, which is the same as
5 volatility. So we can use the word "volatility." So
6 that first column, Consumer in -- Price Index, yes, so
7 if we looked at the very bottom yellow, for example,
8 that's highlighted where it says 0.8 percent, for
9 example?
10 MR. ROBERT WATCHMAN: Yes.
11 MR. VALTER VIOLA: So that 0.8 percent
12 is a volatility measure, which says if the average
13 were -- let's say the Bank of Canada -- let's say this
14 -- I don't have the average here. This is just
15 volatility. So let's say the -- the Bank of Canada 2
16 percent level is the average.
17 If that were the average that was
18 consistent with this .8 percent volatility, what that
19 would say is, think of a bell curve. The average is 2
20 percent inflation and two-thirds (2/3) of the time,
21 the inflation, if this were to repeat itself, would
22 say that the inflation would be 2 percent plus or
23 minus .8 percent, two thirds (2/3s) of the time.
24 So it will go from two (2), to two
25 point eight (2.8), to one point two (1.2). So that

1 point eight (.8) is almost -- is in this period of, in
2 this case, the last twenty-five (25) years is -- is
3 consistent with, say, the Bank of Canada's range in
4 that context. So the 1 percent change is not slight -
5 - is not exactly comparable to this.
6 MR. ROBERT WATCHMAN: But very close?
7 MR. VALTER VIOLA: It's bigger than a
8 -- a 1 percent change on 2 percent level is bigger
9 than a -- a point eight (.8) standard deviation. So
10 it's -- sorry. That's -- it's --
11 MR. ROBERT WATCHMAN: It's very
12 confusing, I know.
13 MR. VALTER VIOLA: It's confusing for
14 me I have to say, that's why we like math.
15 MR. ROBERT WATCHMAN: Which is why we
16 have to ask you the questions.
17 MR. VALTER VIOLA: That's okay.
18 MR. ROBERT WATCHMAN: If I could turn
19 now to the application itself, the DCAT page 68, and
20 you recall that Mr. Scarfone asked you questions about
21 this page yesterday. Do you recall that?
22 MR. VALTER VIOLA: I do.
23 MR. ROBERT WATCHMAN: And -- and so he
24 was referring in DCAT 66 -- sorry, figure DCAT 66, he
25 was referring to the mean for the period set out there

1 for 1915 through 1991, and then again, 1992 --
2 MR. VALTER VIOLA: Yes.
3 MR. ROBERT WATCHMAN: -- and 2017, and
4 pointed out that the mean was 1.8 percent?
5 MR. VALTER VIOLA: Yes.
6 MR. ROBERT WATCHMAN: But in terms of
7 volatility, I take it what we should be looking at is
8 that standard deviation column?
9 MR. VALTER VIOLA: Yes.
10 MR. ROBERT WATCHMAN: And so the
11 standard deviation, or inflation volatility, between
12 1915 and 1991 --
13 MR. VALTER VIOLA: Yeah.
14 MR. ROBERT WATCHMAN: -- was 5.4
15 percent?
16 MR. VALTER VIOLA: Yes.
17 MR. ROBERT WATCHMAN: And for 1992 to
18 19 -- to 2017, .7 percent --
19 MR. VALTER VIOLA: Right. Yes.
20 MR. ROBERT WATCHMAN: -- or seventy
21 (70) basis points?
22 MR. VALTER VIOLA: Yeah.
23 MR. ROBERT WATCHMAN: All right.
24 Getting away from inflation for the moment, I just
25 wanted to turn back to your recommendations at CAC

1 Exhibit 11-2, on page 6. And the next recommendation
2 that I was looking at is number 4, lengthening of the
3 nominal duration.
4 MR. VALTER VIOLA: Yes. Yeah.
5 MR. ROBERT WATCHMAN: Do you see that?
6 And your recommendation is to re-examine the decision
7 to lengthen the nominal duration in the Basic
8 portfolio, given MPI's defensive lower risk strategy,
9 Mercer's return assumption for bonds and RRBs, and
10 concerns about the effectiveness of the duration
11 policy noted above. And then you put in brackets,
12 "(basis risk)."
13 MR. VALTER VIOLA: Yes.
14 MR. ROBERT WATCHMAN: So we're back to
15 basis risk again.
16 MR. VALTER VIOLA: Yes.
17 MR. ROBERT WATCHMAN: And I had
18 directed you to MPI -- the Information Request --
19 MPI/CAC-1-8, which is found at page 17 of that
20 exhibit, and your response on the second page to (b).
21 And I -- I asked you to go through that
22 basis risk, specifically with reference to inflation.
23 Is there anything to add to what you've explained
24 already flowing from the lengthening of the nominal
25 bond duration?

1 MR. VALTER VIOLA: Yes. So -- so let
2 me take a step back. I don't want to be repetitive.
3 Can you just rephrase the last part so I'm hitting
4 your question directly again, please?
5 MR. ROBERT WATCHMAN: Yeah.
6 MR. VALTER VIOLA: Yeah.
7 MR. ROBERT WATCHMAN: So I -- because
8 I had asked you to --
9 MR. VALTER VIOLA: Yeah.
10 MR. ROBERT WATCHMAN: -- and the last
11 time we re-looked at --
12 MR. VALTER VIOLA: Yeah.
13 MR. ROBERT WATCHMAN: -- basis risk, I
14 asked you to focus on the issue of inflation --
15 MR. VALTER VIOLA: Right. Okay. Got
16 it.
17 MR. ROBERT WATCHMAN: -- so now I'm
18 asking if there's anything --
19 MR. VALTER VIOLA: Perfect. Okay. So
20 let's -- I may ask to pull up one (1) of the slides,
21 if you don't mind, from the other day --
22 MR. ROBERT WATCHMAN: No, of course.
23 MR. VALTER VIOLA: -- yesterday. It's
24 the one that shows -- slide 25, please.
25 MR. ROBERT WATCHMAN: And that -- for

1 the record, that's Exhibit CAC-28.
2 MR. VALTER VIOLA: So in this slide,
3 it -- it's to the point of the focus of concern. So
4 again, we -- I believe strongly that changes in real
5 interest rates, which we're about to talk about, and
6 chain -- and unexpected inflation, both are very long
7 horizon risks to worry about that are captured in the
8 nominal liability benchmark portfolio.
9 And I said in this slide here, the --
10 the failure to focus on those two (2) risks is like
11 focusing in a stock portfolio on concerns about the
12 dividend yield on a stock.
13 Dividend yield on a stock is 1 or 3
14 percent, but it's not very volatile. It's always
15 going to be in that range, because dividend policies
16 tend to be predictable, stable, and when you divide
17 dividends by price, it's a -- it's a reasonably stable
18 number.
19 What you worry about when you buy
20 stocks is the fact that stocks go up and down every
21 day, and that's the volatility component. So that's
22 the left side of the bottom panel here in the dividend
23 discount model.
24 And -- and what I said was in the
25 context of the Fisher equation, interest rate risk

1 management, changes in real yields above it are very
2 important because of the long duration that we're
3 talking about, ten (10) years in the case of Basic,
4 sixteen (16) years in the case of pension.
5 So when we go back to your question,
6 maybe you could flip back to it, the fact that we've
7 got a longer duration fixed income portfolio that's
8 all nominal gives me concerns, because if either
9 inflation turns out to be higher than expected, or --
10 or real yields don't behave the same way as nominal
11 ones, nominal bonds may do very poorly in that
12 environment. Does that ans -- does that --
13 MR. ROBERT WATCHMAN: Yes.
14 MR. VALTER VIOLA: -- address the
15 question, sir?
16 MR. ROBERT WATCHMAN: Thank you. I'm
17 now going to go to the next recommendation that I want
18 to ask questions about. And again, if we look at
19 Exhibit CAC-11-2, page 6, and going down to
20 Recommendation Number 7, fixed income risk
21 concentration. Do you see that?
22 MR. VALTER VIOLA: Yes.
23 MR. ROBERT WATCHMAN: And your
24 recommendation in that regard was to re-examine the
25 decision to concentrate risk in fixed income rather

1 than better diversify the sources of risk across the
2 whole portfolio and avoid crowding out risk-reducing
3 real return bonds, correct?
4 MR. VALTER VIOLA: Yes.
5 MR. ROBERT WATCHMAN: And now I'll --
6 PUB provided or asked some -- provided some
7 Information Requests concerning that. And if we could
8 turn to PUB Exhibit 16, PUB/CAC-1-4.
9 And you were asked to explain how MPI -
10 - you believe MPI should design its portfolio for
11 Basic to diversify the sources of risk across --
12 across the board -- the whole portfolio.
13 And if we turn the page, about halfway
14 down and just above that graph, you state:
15 "In other words, the attractiveness
16 of any asset class should be
17 assessed not in isolation but in the
18 context of the other assets that are
19 in the portfolio or contemplate --
20 contemplated to be in the
21 portfolio."
22 And I take it that's -- that's the sort
23 of crux of your position?
24 MR. VALTER VIOLA: Yes.
25 MR. ROBERT WATCHMAN: And I won't ask

1 you to explain the -- the graph, but we understand
2 that that's how the efficient frontier is determined.
3 And if I turn to the next page, the
4 second paragraph there, MPI has stated that it has low
5 tolerance for risk in the Basic portfolio, and
6 therefore, MPI has decided to allocate 100 percent to
7 fixed income in that portfolio. I would argue that
8 the decision to impose a constraint, 0 percent to
9 other asset classes as a cost, i.e., lower risk-
10 adjusted returns.
11 And so we -- when we heard you speak
12 yesterday about constraint, this is what you were
13 referring to?
14 MR. VALTER VIOLA: This is one (1)
15 example of it, yes.
16 MR. ROBERT WATCHMAN: Now if we could
17 just turn two (2) pages, and there's a table there.
18 Can you just advise us who -- who created this table?
19 MR. VALTER VIOLA: I created the table
20 based on data from the GRA or one (1) of the
21 Information Requests. It -- and it's from the Mercer
22 study. So either the two (2) responses that came from
23 our request for information, or the GRA.
24 MR. ROBERT WATCHMAN: And so -- so
25 just to be clear, this --

1 MR. VALTER VIOLA: Yes.
2 MR. ROBERT WATCHMAN: -- this -- this
3 doesn't represent your recommendation --
4 MR. VALTER VIOLA: No, the --
5 MR. ROBERT WATCHMAN: -- this is what
6 you gleaned from the information --
7 MR. VALTER VIOLA: Correct. Right.
8 MR. ROBERT WATCHMAN: -- provided?
9 MR. VALTER VIOLA: So the current is
10 my -- is the current portfolio as defined by Mercer by
11 the letter 'C'. 'B' is one (1) scenario in the -- in
12 the real analysis, so my -- in response to my two (2)
13 questions, 85, is it, 'G', I think. And the proposed
14 is what actually MPI proposes, not me, in the final
15 columns, the difference between the proposed and the
16 one (1) with the same risk.
17 MR. ROBERT WATCHMAN: And now -- and
18 to the left of the table, the second paragraph there
19 says:
20 "In other words, the sources of risk
21 in the current and MPI proposed
22 portfolios -- portfolios have
23 concentrated risk in inflation and
24 credit."
25 MR. VALTER VIOLA: Yes.

1 MR. ROBERT WATCHMAN: Can you show
2 where that --
3 MR. VALTER VIOLA: Okay. So that's --
4 let's look at the -- the proposed. The proposed has -
5 - so that's the (P) column, second to the -- it's the
6 (P) column. It says it has 20 percent allocation to
7 corporate bonds, and 80 percent to provincial. So the
8 whole portfolio is fixed-income, a hundred percent,
9 and the corporate bond portfolio as distinct from,
10 say, a federal bond portfolio, means that there's
11 credit risk.
12 Corporate bonds are issued by
13 corporations, and they're more likely to default on
14 the -- their ability to pay than a Government of
15 Canada or provincial, and therefore, those -- anyways,
16 that's a fact. And provincial bonds also have a small
17 credit risk relative to less risky federal bonds.
18 That's in the proposed portfolio. And
19 because they're both nominal bonds, in other words,
20 there's no federal RRBs in there -- in that proposal,
21 there's a zero allocation to real return bonds --
22 everything else has inflation risk. T-bills don't,
23 but there's no allocation to that, either.
24 MR. ROBERT WATCHMAN: Now, am I to
25 understand that the asset class breakdown that would

1 best reduce concentrated risk would be the (B) column?
2 MR. VALTER VIOLA: Well, yes. So
3 again -- well, sorry, let me make sure I answer your
4 question correctly. Could you rephrase it again,
5 please.
6 MR. ROBERT WATCHMAN: Yes, the concern
7 expressed there that was that the MPI proposed
8 portfolio, or current portfolio have concentrated risk
9 and inflation and credit.
10 MR. VALTER VIOLA: Right.
11 MR. ROBERT WATCHMAN: So, relative to
12 those would be reduced that concentrate --
13 MR. VALTER VIOLA: Yes because you can
14 see it's better diversified.
15 In other words, if you look at just the
16 fixed income, the upper-half of the panel, it's only
17 got 68 percent in bonds and it's -- it's better
18 diversified.
19 Now, it takes other kinds of risk in
20 that portfolio because it's got 23 1/2 percent in
21 equities, so the -- the risk is spread out across
22 asset classes, not just fixed income, and -- and this
23 was a -- this was a difficult table to put together
24 because I didn't have the numbers to fully populate
25 it.

1 But the interesting -- anyways, we'll
2 leave it at that. It's -- there's less concentration
3 of risk in the B portfolio, but to be fair, the P, the
4 proposed in the same risk portfolio are not strictly
5 comparable because of the -- I don't have the numbers,
6 but there's different return and volatility
7 assumptions in those second -- the B and the P column.
8 MR. ROBERT WATCHMAN: And if --
9 MR. VALTER VIOLA: Mercer could
10 quantify those effects, but...
11 MR. ROBERT WATCHMAN: And as it
12 relates to your bucket analogy yesterday --
13 MR. VALTER VIOLA: Yes.
14 MR. ROBERT WATCHMAN: -- about a top -
15 - top down view would have --
16 MR. VALTER VIOLA: Yes.
17 MR. ROBERT WATCHMAN: -- similar asset
18 mix, different levels of water.
19 MR. VALTER VIOLA: Yes.
20 MR. ROBERT WATCHMAN: Again, does B
21 best represent what you were saying in terms of that
22 bucket analogy?
23 MR. VALTER VIOLA: Yes, so B -- B I
24 would say yes. B is reflective of that. So when
25 Mercer does their asset liability study, they have a

1 minimum risk portfolio, that risk-free bucket, and it
2 consists of, in the case of Basic, two-thirds (2/3s)
3 real return bonds.
4 And now what we're questioning is how
5 far along the efficient frontier does this B column
6 go. It's not the least risky. It doesn't look like
7 the minimum -- the liability benchmark portfolio,
8 which is not shown here because it has some equities
9 in it.
10 But it is basically saying -- and it's
11 -- yes, is the quick answer. You're going along and
12 you're moving the allocations of the size of the
13 pails, but the mix should be roughly the same, yes.
14 MR. ROBERT WATCHMAN: Thank you.
15 MR. VALTER VIOLA: That's how models
16 work.
17 MR. ROBERT WATCHMAN: Okay, thank you.
18 And if we could turn to the next page, and this is in
19 response to part B of that Information Request, and
20 the question was: What level of RRBs and Basic -- or
21 should be in Basic and pension portfolios.
22 And you defined risk and tolerance for
23 risk. And at the bottom of the page you indicate the
24 allocation to real return bonds based upon risk
25 tolerance for each of the Basic and pension

1 portfolios.

2 MR. VALTER VIOLA: Yes.

3 MR. ROBERT WATCHMAN: And again, this

4 is based on Mercer's analysis. This isn't necessarily

5 your recommendation?

6 MR. VALTER VIOLA: Correct.

7 MR. ROBERT WATCHMAN: And I just want

8 to clarify something here for the record. In your

9 written responses and in your report, which is now CAC

10 Exhibit 11 -- 11-2, you refer a number of times to MPI

11 Exhibit 12.

12 And just to clarify, for the record, at

13 the time that MPI Exhibit 12, which was the further

14 analysis conducted by Mercer pursuant to Board Order

15 124/'18, that was -- it was anticipated that that

16 would be Exhibit 12.

17 By the time the -- these hearings

18 started, it was determined that the exhibit number had

19 already been used and this exhibit is now Exhibit 15

20 in these proceedings.

21 So whenever we see a reference to

22 Exhibit 12, MPI Exhibit 12 in your written materials,

23 we now read that as MPI Exhibit 15, correct?

24 MR. VALTER VIOLA: That is correct.

25 And so this just goes to the point of how hard it is

1 to forecast even just a couple of weeks.
2 MR. ROBERT WATCHMAN: Moving on then,
3 I wanted to refer to again your CAC Exhibit 11-2, at
4 this time, page 23, in which you -- you set out a bit
5 of a scorecard there as to the response to your
6 recommendations from two (2) years ago.
7 And if we look at the first block
8 there, the last item number 10, minimum risk
9 portfolio.
10 MR. VALTER VIOLA: Yes. Yes.
11 MR. ROBERT WATCHMAN: And -- and
12 again, just for the record, minimum risk portfolio
13 equates to liability benchmark portfolio as used in
14 the application and in the Mercer study.
15 MR. VALTER VIOLA: That's correct.
16 MR. ROBERT WATCHMAN: And the
17 indication there is that the minimum risk portfolio
18 has only been partially addressed.
19 And if we turn the page we see there
20 the -- your comment is, well, minimum risk portfolios
21 were clearly defined for each segment, for example,
22 Basic and pensions.
23 The final definitions used by MPI were
24 based on nominal definitions rather than real ones, as
25 discussed in part one. Accordingly, this issue is

1 only partially addressed.
2 And can I ask you: So was this not
3 addressed in MPI Exhibit 15, the further analysis
4 conducted by Mercer?
5 MR. VALTER VIOLA: It was, from an
6 analytical point of view. But in terms of taking
7 action on it, that's where the outstanding issue is.
8 MR. ROBERT WATCHMAN: Thank you. Now,
9 again, PUB provided Information Requests with respect
10 to the minimum risk portfolio, and we will find that
11 question at PUB Exhibit 16, starting at page 5. And
12 if we could just scroll down. Actually, to the top of
13 the nest -- next page.
14 And the point that you made there, in
15 bold, is that the minimum risk portfolio should
16 include at least some long-duration real return bonds
17 given the nature of MPI's liabilities, long-term and
18 with some inflation exposures, correct?
19 MR. VALTER VIOLA: Yes.
20 MR. ROBERT WATCHMAN: And if we scroll
21 down a little bit further, we see another table, so
22 I'll ask you again where this table comes from.
23 MR. VALTER VIOLA: This comes from the
24 GRA. So I simply extracted data that was provided by
25 MPI or Mercer. And it was included as a preamble to

1 some of my questions.
2 MR. ROBERT WATCHMAN: And -- okay. So
3 this is the table where, when we look at the left-hand
4 part of the table, it's dealing with the Basic
5 portfolio, or the --
6 MR. VALTER VIOLA: Yes.
7 MR. ROBERT WATCHMAN: Yes. And this
8 is where the reference to 66 percent real return bonds
9 comes from?
10 MR. VALTER VIOLA: Yes.
11 MR. ROBERT WATCHMAN: And again, so
12 that's not your recommendation, that's what you ---
13 MR. VALTER VIOLA: That's what Mercer
14 said was the liability benchmark portfolio if you took
15 inflation and real interest rate risk into account
16 explicitly in their model.
17 MR. ROBERT WATCHMAN: And we -- when
18 we look at the transition from nominal to real under
19 Basic, we see that what is being given up in order to
20 provide for more real return bonds and more treasury
21 bills, is first the long-term provincial bonds, then
22 the mid-term bonds and some but not all of the short-
23 term bonds, correct?
24 MR. VALTER VIOLA: Yes.
25 MR. ROBERT WATCHMAN: So -- and that's

1 the -- the -- does that correspond with your concern
2 that those bonds don't guard against inflation risk?
3 MR. VALTER VIOLA: Yes.
4 MR. ROBERT WATCHMAN: And so
5 similarly, when we look at the pension side of the
6 table, that's where we -- we see under the real that's
7 where the 81 percent real return bonds comes from.
8 MR. VALTER VIOLA: Yes.
9 MR. ROBERT WATCHMAN: And so again,
10 that's not -- that's not your recommendation. That's
11 what you determined from the Mercer analysis.
12 MR. VALTER VIOLA: Correct. And if I
13 could just make one (1) elaborating point, if that's
14 okay?
15 MR. ROBERT WATCHMAN: Yes.
16 MR. VALTER VIOLA: In the -- the first
17 set of colour columns under "Basic", that difference -
18 - that column of difference which sums to zero shows
19 the difference in the market value exposure of the
20 liability benchmark portfolio under the two (2)
21 scenarios, and it is the source of that 4 1/2 percent
22 basis risk.
23 If those columns summed to zero, they
24 were all zero, there would be no basis risk because
25 the first two (2) columns would be the same. There

1 would be no difference.
2 And this is -- perhaps it's probably
3 visual, I think I said it verbally yesterday, but if
4 you look at the far right column there's greater
5 difference between the bottom two (2) panels, 81 and
6 negative 1-17, and that's why I suggested that perhaps
7 in the case of pension the basis risk might be higher
8 than 4.5 percent, although Mercer didn't quantify it.
9 MR. ROBERT WATCHMAN: Thank you.
10 MR. VALTER VIOLA: You're welcome.
11
12 (BRIEF PAUSE)
13
14 MR. ROBERT WATCHMAN: I'm going to
15 turn now to PUB -- PUB-CAC-1-6, beginning at page 17.
16 And here you were asked, with respect
17 to the level of other inflation hedging assets, such
18 as real estate and infrastructure, you believe should
19 be maintained.
20 And you begin by -- your response by
21 referring to certain information beliefs, if we go to
22 page 18 and -- and if we go scroll down we see a
23 belief number 3. And I believe these were reviewed
24 yesterday, the additional risk -- taking additional
25 risk beyond the minimum risk portfolio should be done

1 only if the expected additional returns justify doing
2 so.
3 And secondly, below -- belief 4, the
4 total portfolio. The additional risk to the to --
5 total portfolio is relevant to risk if considered
6 beyond the minimum risk portfolio is taken.
7 And then you say:
8 "Together, beliefs 3 and 4 imply
9 that the attractiveness of any asset
10 class should be assessed not in
11 isolation, but in the context of the
12 other assets that are in the
13 portfolio or contemplated to be in
14 the portfolio."
15 And that was, if I'm correct, was that
16 sort of the definition of the efficient frontier?
17 MR. VALTER VIOLA: Yes, an efficient
18 frontier always measures it this way. It always takes
19 a total portfolio context and it makes those trade-
20 offs that we will mathematically find difficult to --
21 to take into account because of the correlation
22 effects.
23 MR. ROBERT WATCHMAN: And if we turn
24 the page. So there is reference there specifically to
25 real estate and infrastructure.

1 So is my understanding correct that
2 what you're saying is that in addition to real return
3 bonds, real estate and infrastructure investment can
4 also provide a hedge against inflation risk?
5 MR. VALTER VIOLA: Yes. And you have
6 to be careful because there are different types of
7 real estate and infrastructure, for example. Some --
8 depending on the nature of the underlying, they
9 provide more or less inflation protection, yes.
10 MR. ROBERT WATCHMAN: And if we could
11 turn the page, please. And so now this is a table
12 taken from the Mercer report, correct?
13 MR. VALTER VIOLA: Yes.
14 MR. ROBERT WATCHMAN: And we -- we
15 refer to that as the asset mix? Yes?
16 MR. VALTER VIOLA: Yes. Yes.
17 MR. ROBERT WATCHMAN: And -- and if we
18 scroll down to the bottom of that box, the conclusion
19 underneath, from your analysis, or sorry, I shouldn't
20 say that, your analysis of Mercer's analysis, if I can
21 put it that way --
22 MR. VALTER VIOLA: Right.
23 MR. ROBERT WATCHMAN: -- was that
24 optimal allocation to real estate infrastructure would
25 be something like 16 percent to 20 percent of the RRB

1 allocation for Basic.
2 Is that correct?
3 MR. VALTER VIOLA: Correct. And
4 again, I can't be precise because if you think about
5 the efficient frontier, that shows return risk trade-
6 offs, it would be nice to have underneath that the
7 table that shows the asset mix and how that allocation
8 shifts. And what you don't see is things falling off
9 a cliff and going randomly. Things are always smooth
10 transitions.
11 And -- and that's why when I talk about
12 the buckets and looking down, in the riskier bucket,
13 what you're seeing is more allocations typically,
14 basically looking into the bigger pail as you go from
15 left to right in the risky bucket.
16 MR. ROBERT WATCHMAN: So now if we
17 could turn the page, please, to page 21.
18 And now, this is the -- the same
19 analysis done in respect of the pension portfolio?
20 MR. VALTER VIOLA: Yes.
21 MR. ROBERT WATCHMAN: And if we go to
22 the next page, to the conclusion, my understanding is
23 that your understanding of the Mercer analysis is that
24 for the pension portfolio, real estate and -- and
25 infrastructure investment should be about 6 percent to

1 8 1/2 percent of the real return bonds.
2 MR. VALTER VIOLA: Yes. And again,
3 I'm sort of using a rough rule of thumb, but based on
4 the numbers that I see in the tables.
5 MR. ROBERT WATCHMAN: Now, if I could
6 -- I should have asked when we were looking at real
7 return bonds and the analysis there was based upon
8 what Mercer had determined.
9 Do you have any opinion as to what
10 level of investment should be made for Basic portfolio
11 and the pension portfolio in real return bonds?
12 MR. VALTER VIOLA: I -- I think we put
13 up one (1) of the earlier IR requests. There was a
14 table at the bottom with a bunch of bullet points, if
15 we could pull that up again, it did provide a range
16 because the answer would depend on tolerance for risk.
17 MR. ROBERT WATCHMAN: Yes, and I
18 believe it was ---
19 MR. VALTER VIOLA: It was a question
20 from the utilities -- Public Utilities Board. If you
21 pull up the slide, I could just --
22 MR. ROBERT WATCHMAN: Yes, and I
23 believe that would be PUB Exhibit 16, page 13.
24 MR. VALTER VIOLA: At the very bottom.
25 There you go.

1 So in the case of Basic and -- would
2 you like me to read it, and that might answer the
3 question?
4 MR. ROBERT WATCHMAN: Yes, I just -- I
5 guess what I want to do is draw the distinction
6 between the Mercer analysis and what you --
7 MR. VALTER VIOLA: Right.
8 MR. ROBERT WATCHMAN: -- would say
9 would be the optimal --
10 MR. VALTER VIOLA: Right. And again,
11 and -- and this does sort of answer it because a) I
12 don't have the asset liability model in front of me.
13 I have no reason to doubt that it was -- I mean, I'm
14 sure it was done accurately reflecting all the
15 assumptions.
16 What I don't know is what level of
17 risk, tolerance for risk, along the bottom axis and
18 the efficient frontier, where you want to go.
19 So I set a range here. So I'll say
20 number B, for example, in B in the case of pension and
21 E in the case of -- sorry.
22 The letter B, where it says 60 percent;
23 that's the allocation if MPI, in the Basic portfolio,
24 had zero tolerance for risk. They wanted to minimize
25 it because that's the allocation of the liability

1 benchmark portfolio, by definition that's the least
2 risky.
3 So if you want to -- if you have a very
4 low, i.e., zero tolerance for risk in Basic and you
5 used the real analysis that Mercer did, then you would
6 put 60 percent in real return bonds.
7 And if you were in the pension fund and
8 you said I want to take no risk, recognizing that
9 inflation risk exists in real interest rate risk, you
10 would have 81 percent.
11 Now, those are extremes, that says
12 taking no risk. No risk being in aggregate, including
13 -- well, minimum risk, let's call it minimum risk.
14 That's why I defined it as minimum risk portfolio
15 rather than zero risk.
16 If you were to move from left to right
17 along that spectrum of risk from low tolerance to
18 higher, the allocation would fall. So let's talk
19 about Basic.
20 So instead of 66 percent in answer B,
21 you would say, again, I'm just relying on the graphs
22 that Mercer gave us because I don't have an asset
23 liability model in front of me.
24 If you chose to keep the same risk as
25 they defined it as (c), I believe, current risk, or B,

1 I can't recall, but they used the consistent lettering
2 for the current risk level with new capital market
3 assumptions.
4 Then the allocation would be less than
5 66, it will fall to 40 percent. And if -- if -- if
6 you have low tolerance for risk, somewhere between
7 where the current portfolio's risk profile was to the
8 least possible, it would be somewhere between 40 and
9 66 percent.
10 MR. ROBERT WATCHMAN: Now, in the
11 earlier part of your response there, I think you might
12 have said in respect of Basic, 60 percent, but I think
13 you --
14 MR. VALTER VIOLA: I meant 66. Sorry,
15 I apologize for that.
16 MR. ROBERT WATCHMAN: Thank you.
17 Now, I want to turn now to --
18 MR. VALTER VIOLA: Can I make one (1)
19 additional comment, just for context, because this is
20 -- there's a lot of numbers.
21 You will recall that yesterday I showed
22 the time series of the allocations of the Ontario
23 Teachers Pension Plan?
24 MR. ROBERT WATCHMAN: Yes.
25 MR. VALTER VIOLA: This is a fund that

1 takes a lot of risk, and yet it has about -- a few
2 years ago, two (2) years ago when I presented it had
3 19 percent in these kinds of assets.
4 So almost 20 percent, 1 in 5 dollars,
5 despite the fact that it was -- so it was further
6 along the risk spectrum. It's a different level of
7 risk, it's a pension fund, not an insurance company
8 with a pension plan as well. That -- that just
9 provides context for, you know.
10 MR. ROBERT WATCHMAN: Thank you. I
11 want to turn now to -- to your slides from yesterday,
12 CAC Exhibit 28. And I want to look at Slides 36 and
13 37. And starting with slide 36.
14 Now -- so my understanding is -- is
15 that the Basic graph itself was provided by Mercer in
16 their further analysis?
17 MR. VALTER VIOLA: Yes.
18 MR. ROBERT WATCHMAN: What is now
19 exhibit -- MPI Exhibit 15.
20 MR. VALTER VIOLA: Yes.
21 MR. ROBERT WATCHMAN: And then you
22 just superimposed the dotted lines and commentary in
23 red.
24 MR. VALTER VIOLA: Yes.
25 MR. ROBERT WATCHMAN: Which

1 highlighted what you referred to as opportunity cost?
2 MR. VALTER VIOLA: Yes.
3 MR. ROBERT WATCHMAN: And you spoke
4 too about the opportunity cost, perhaps in terms of
5 Basic, being only .8 percent, but you have to look at
6 that over a long period of time.
7 MR. VALTER VIOLA: It's per year. So
8 this is an expectation over the time horizon, yeah, so
9 it's an annualized opportunity cost.
10 MR. ROBERT WATCHMAN: So is there any
11 way of quantifying that opportunity cost?
12 MR. VALTER VIOLA: Multiply it -- in
13 dollars, multiply it by the assets under management,
14 and that's the foregone increase in value.
15 MR. ROBERT WATCHMAN: And when we --
16 when these slides were introduced yesterday, I think
17 you made the comment that it doesn't -- doesn't
18 contain the usual table that the Mercer graphs
19 provided?
20 MR. VALTER VIOLA: Yes. The -- as you
21 recall, the Mercer did a step type of approach and
22 this was the last step I think that they took it out,
23 so it was the only basis from which I could draw some
24 conclusions so.
25 MR. ROBERT WATCHMAN: Okay. And so

1 perhaps we should turn then to MPI Exhibit 15,
2 starting at what is page 6, slide -- so it ends up
3 being Slide 5.
4 And so this is the analysis for the
5 real liability benchmark for Basic?
6 MR. VALTER VIOLA: Yes.
7 MR. ROBERT WATCHMAN: And we see in
8 the -- if we turn the page and in the next five (5)
9 pages we have the graphic representation and then we
10 have the table on the side.
11 MR. VALTER VIOLA: Yes.
12 MR. ROBERT WATCHMAN: And if we turn
13 to page 12.
14 MR. VALTER VIOLA: Yes.
15 MR. ROBERT WATCHMAN: Okay, so this is
16 the slide that you took that didn't have the table.
17 MR. VALTER VIOLA: Correct.
18 MR. ROBERT WATCHMAN: And that's what
19 became your slide -- what number was that last one?
20 MR. VALTER VIOLA: 36.
21 MR. ROBERT WATCHMAN: 36.
22 MR. VALTER VIOLA: Yes.
23 MR. ROBERT WATCHMAN: And so if we --
24 we can look at the same if we go later in the report,
25 starting at page 18 and the pages following, we have

1 that same analysis in respect of pension?
2 MR. VALTER VIOLA: Yes.
3 MR. ROBERT WATCHMAN: And then we get
4 to page 24. And this is the slide that you used for
5 pension, which became your Slide 37 --
6 MR. VALTER VIOLA: Yes.
7 MR. ROBERT WATCHMAN: -- correct?
8 Now, if we could just go back to Slide 36 from CAC
9 Exhibit 28, and you recall yesterday that Mr. Scarfone
10 asked you some questions about the difference between
11 the -- the top line and the current.
12 MR. VALTER VIOLA: Yes.
13 MR. ROBERT WATCHMAN: And the point
14 that Mr. Scarfone was making is that -- so with the
15 removal of RRBs we don't know what happens -- how
16 those monies are reinvested.
17 Do you recall that question?
18 MR. VALTER VIOLA: Yes. Yes, I do.
19 MR. ROBERT WATCHMAN: And -- and the
20 point that Mr. Scarfone was was well they could --
21 they might be invested in private equity or private
22 debt, some more riskier.
23 MR. VALTER VIOLA: Right.
24 MR. ROBERT WATCHMAN: And the question
25 that was asked of you was well, but you -- you can't

1 say how the monies were reinvested in the preparation
2 of this chart.
3 MR. VALTER VIOLA: Correct.
4 MR. ROBERT WATCHMAN: And is the
5 reason you can't say is because Mercer didn't provide
6 that information?
7 MR. VALTER VIOLA: The quick answer is
8 yes. Yeah, what's -- what's nice to have when these
9 are done is underneath it is the asset allocations
10 that correspond to various dots along the efficient
11 frontiers.
12 If you recall in prior studies, those
13 were -- I think -- I believe those were available, but
14 I'm not sure.
15 MR. ROBERT WATCHMAN: Thank you, Mr.
16 Viola. Thank you, Mr. Chair, those are all our
17 questions.
18 THE CHAIRPERSON: Thank you. We're
19 going to take a break for fifteen (15) minutes and
20 then go into CS -- sorry, re-examination. Pardon me,
21 Mr. Williams, sorry.
22
23 RE-DIRECT EXAMINATION BY DR. BYRON WILLIAMS:
24 DR. BYRON WILLIAMS: Just a couple of
25 questions.

1 Mr. Viola, you recall a conversation
2 with My Learned Friend, Mr. Scarfone, from Manitoba
3 Public Insurance in terms of the Ontario Teachers Fund
4 Composition yesterday?
5 MR. VALTER VIOLA: Yes.
6 DR. BYRON WILLIAMS: Do you have
7 access to the most recent annual report of the Ontario
8 Teachers --
9 MR. VALTER VIOLA: Yes. We --
10 DR. BYRON WILLIAMS: Okay. If
11 requested by the Public Utilities Board, would you be
12 able to provide an up-to-date analysis based upon the
13 most recent annual report?
14 MR. VALTER VIOLA: Certainly, yes.
15 DR. BYRON WILLIAMS: No further
16 questions.
17 THE CHAIRPERSON: Thank you.
18 We'll take a fifteen (15) minute break
19 and then we will go into CSI.
20 Kristen, if you could cut off the live
21 stream at this point. Thank you.
22
23 --- Upon recessing at 10:14 a.m.
24
25 (CSI PORTION UNDER SEPARATE COVER)

1 --- Upon resuming at 11:05 a.m.
2
3 THE CHAIRPERSON: Okay, we're back
4 into open session, but I guess we're not ready.
5
6 (BRIEF PAUSE)
7
8 MR. STEVE SCARFONE: Mr. Chair, could
9 I speak to an exhibit that needs some clarification?
10 THE CHAIRPERSON: Is this the same
11 exhibit Mr. --
12 MR. STEVE SCARFONE: No.
13 THE CHAIRPERSON: Okay. Certainly,
14 Mr. Scarfone.
15 MR. STEVE SCARFONE: Okay. Thank you.
16 So, I just was asked by the Board Secretary to bring
17 to the Board's attention that MPI Exhibit 48,
18 previously filed, is the same exhibit that MPI filed
19 apparently as CSI-7 -- just as -- it's a little
20 unorthodox to have two (2) exhibit numbers for the
21 same thing, but that's -- that's what occurred, I'm
22 told by Mr. Christle.
23 THE CHAIRPERSON: Okay. So Exhibit 48
24 then is -- is -- is a public document?
25 MR. STEVE SCARFONE: Yes.

1 THE CHAIRPERSON: Okay. Thank you.
2 MR. STEVE SCARFONE: Thank you.
3 THE CHAIRPERSON: Appreciate that.
4 Mr. -- Mr. Williams, are we ready or...
5
6 (BRIEF PAUSE)
7
8 DR. BYRON WILLIAMS: So, Ms. -- I just
9 for the record I want to indicate that Ms. Dilay's
10 more efficient than Mr. Viola.
11 But, Mr. Chair, this is a collaborative
12 exhibit jointly being -- like MP -- based upon
13 collaborative discussions with MPI and CAC Manitoba.
14 And you'll recall in -- in cross-
15 examination yesterday, MPI asked for commentary
16 regarding the Ontario Teachers' Pension Fund, their
17 composition of real assets, and I just want to
18 indicate, we are going to be providing in -- in a full
19 exhibit, first of all, an excerpt from the Ontario
20 Teachers Pension Plan Annual Report the eleven (11)
21 year financial review just one (1) page, being page 95
22 and then, as well, from the Ontario Pension Plan's
23 website an excerpt relating to the performance of its
24 Pension Plan, pages 1 and 2 of that.
25 As I said, this was based upon

1 conversation with MPI, so I -- I'm -- I'm going to ask
2 --
3 THE CHAIRPERSON: So -- sorry. Are we
4 giving this an -- an exhibit number?
5 DR. BYRON WILLIAMS: Yes. We'll give
6 it, I'll suggest CAC-29.
7 THE CHAIRPERSON: Thank you.
8
9 --- EXHIBIT NO. CAC-29: Excerpt from the Ontario
10 Teachers Pension Plan
11 Annual Report the eleven
12 (11) year financial review
13 just one (1) page, being
14 page 95 and then from the
15 Ontario Pension Plan's
16 website an excerpt
17 relating to the
18 performance of its Pension
19 Plan, pages 1 and 2 of
20 that.
21
22 CONTINUED RE-DIRECT EXAMINATION BY DR. BYRON WILLIAMS:
23 DR. BYRON WILLIAMS: And perhaps we'll
24 go to the -- referring to the website page -- the
25 second page of it. Yeah, the second page, please,

1 Kristen.

2 Okay, Mr. -- we'll -- Mr. Viola, I'll

3 direct your attention -- this is fine, Kristen, right

4 -- right where -- where it is -- to under real assets,

5 you'll see a line saying "real rate products."

6 Do you see that, Mr. Viola,

7 MR. VALTER VIOLA: Yes. Yes.

8 DR. BYRON WILLIAMS: It's about two-

9 thirds (2/3s) of the way down the page

10 MR. VALTER VIOLA: Yes.

11 DR. BYRON WILLIAMS: And you recall a

12 question from MPI asking if you'd be surprised if

13 there was -- if you were told that teachers had 1.5

14 billion in real product, real rate products?

15 MR. VALTER VIOLA: Yes.

16 DR. BYRON WILLIAMS: Okay, so you see

17 the 1.5 billion there, sir.

18 MR. VALTER VIOLA: Yes.

19 DR. BYRON WILLIAMS: I wonder if you

20 could go up under "fixed income," on the same page up

21 to "real rate products" and you'll see another figure

22 there, sir, of -- I'll suggest to you 20 billion?

23 MR. VALTER VIOLA: Yes.

24 DR. BYRON WILLIAMS: And then if we

25 can go down under "inflation sensitive," you'll also

1 see reference to an inflation hedge, sir, of 8.9
2 billion?
3 MR. VALTER VIOLA: Yes.
4 DR. BYRON WILLIAMS: And finally, sir,
5 you'll see reference under real assets to real estate
6 of 25.5 billion, and infrastructure of 18.7 billion?
7 MR. VALTER VIOLA: Yes.
8 DR. BYRON WILLIAMS: And just to the
9 bottom line of this net investment of the fund, it's
10 in the range of 185 billion, sir?
11 MR. VALTER VIOLA: Yes.
12 DR. BYRON WILLIAMS: Is there anything
13 you want to add in terms of explanation?
14 MR. VALTER VIOLA: Sure. The -- so
15 when you add those inflation sensises -- sensitive and
16 real rate products up, I think the number you come up
17 with is about 16 percent of the portfolio, if I'm not
18 mistaken.
19 And if we go to one (1) of the exhibits
20 that I showed yesterday, Slide 21, again, that's the
21 exhibit unaltered from two (2) years ago, which was
22 designed to support discussion about the asset mix
23 that a fund like a big fund had, and noting that $1 in
24 five, 19 percent was in what we called, real rate
25 products.

1 It looks like Teachers in the last year
2 or so has reclassified things, but at the end of the
3 day, they still have a lot of interest rate -- sorry,
4 inflation and real rate protection through but they've
5 just classified things a little differently.
6 So -- so the 19 percent that you saw at
7 the end of 2015, if we go two (2) years now to the end
8 of 2017 for the website and the finan -- and the
9 annual report, it looks like the number's down a
10 little bit by 3 percent.
11 DR. BYRON WILLIAMS: Okay. And I
12 thank you and -- and Mr. Chair, we do appreciate the
13 collaborative efforts of MPI just because we were
14 jointly concerned with the record, and we appreciate
15 that My Learned Friends approaching us on this issue.
16 THE CHAIRPERSON: Thank you. Mr.
17 Scarfone, did you have any questions in relation to
18 this? Certainly.
19 MR. STEVE SCARFONE: Just one (1) ,
20 Mr. Chair, and -- and I too thank My Learned Friend
21 for allowing us to clarify. Perhaps I do have two (2)
22 questions.
23
24 RE-CROSS-EXAMINATION BY MR. STEVE SCARFONE:
25 MR. STEVE SCARFONE: Is there any

1 particular reason that you're aware of, Mr. Viola, why
2 the -- why your former employer breaks down their --
3 the real rate products in the manner they do?
4 MR. VALTER VIOLA: The quick answer is
5 I don't, but I can have a couple hypotheses, different
6 benchmarks for different components and different
7 accountability for actually managing the underlying
8 assets.
9 MR. STEVE SCARFONE: I see.
10 MR. VALTER VIOLA: And it could be
11 that some are just meant to be buy and hold and park
12 them and sit there and -- and basically don't try to
13 beat the benchmark and -- but I don't know. Those --
14 those are just two (2) theories.
15 MR. STEVE SCARFONE: Okay. My -- my
16 second question, excuse me. So of those three (3)
17 components, the 20 billion, the 1.5 billion and the 9
18 billion in the inflation hedge, do we know what
19 percentage of the -- that total would constitute real
20 return bonds?
21 MR. VALTER VIOLA: The quick answer is
22 no, I don't have it. I mean, I -- I -- I skimmed the
23 annual report briefly. It was hard to figure it out.
24 I suspect that, you know what, you could look at the
25 index. They usually list the big holdings. I haven't

1 looked at those, but --
2 DR. BYRON WILLIAMS: Okay.
3 MR. VALTER VIOLA: -- but we could.
4 MR. STEVE SCARFONE: But I gather you
5 would expect that a large majority of that would
6 comprise real return bonds?
7 MR. VALTER VIOLA: I'd be surprised if
8 they sold a big chunk of them, but again, who knows,
9 in the context of the whole portfolio, who knows what
10 they could've done. But we could -- we could look at
11 -- of the long listing and compare years over years or
12 we could -- we could probably do that very -- fairly
13 quickly. I haven't done it though.
14 MR. STEVE SCARFONE: Okay. Thank you.
15 Those are my questions.
16 THE CHAIRPERSON: Thank you. Mr.
17 Watchman, any questions?
18 MR. ROBERT WATCHMAN: No questions,
19 Mr. Chair.
20 THE CHAIRPERSON: Mr. Williams, any
21 re-exam?
22 DR. BYRON WILLIAMS: No, re-exam, Mr.
23 Chair, and Members of the Panel. We thank you for
24 your courtesy.
25 THE CHAIRPERSON: Thank you very much

1 and thank you very much, Mr. Viola.
2 MR. VALTER VIOLA: My pleasure. Thank
3 you.
4
5 (WITNESS STANDS DOWN)
6
7 THE CHAIRPERSON: Okay, that concludes
8 the -- the evidence portion of the hearing. We're now
9 going to proceed to closing submissions and we'll
10 start with Board Counsel.
11
12 (BRIEF PAUSE)
13
14 THE CHAIRPERSON: Thank you. Ms.
15 McCandless...?
16
17 CLOSING COMMENTS BY MS. KATHLEEN MCCANDLESS
18 MS. KATHLEEN MCCANDLESS: Thank you.
19 We have now completed the evidentiary portion of this
20 public hearing with respect to the 2019 General Rate
21 Application or GRA filed by Manitoba Public Insurance.
22 The Board will soon deliberate on the
23 application for base rates and premiums charged for
24 compulsory vehicle and driver vehicle insurance to
25 take effect on March 1, 2019.

1 As counsel to the Board, I do not take
2 any position on the merits of any part of the
3 Application or the positions taken by any of the
4 parties. My role is to summarize the matters that are
5 before the Board and outline issues that it may wish
6 to consider in making its decisions.
7 In its Application the Corporation has
8 requested a 2.2 percent overall increase in Basic
9 premium revenue comprised of .1 percent increase,
10 reflecting the break-even cost of policies, and a 2.1
11 percent increase for a net capital maintenance
12 provision to maintain Basic's capital position through
13 the rating year.
14 This is the first time the Corporation
15 has sought a Capital Maintenance Provision. This step
16 is being taken further to PUB Order 130/'17, which
17 required that a technical conference take place,
18 seeking a consensus approach to estimating a Capital
19 Maintenance Provision, and which technical conference
20 took place on March 2nd, 2018.
21 MPI seeks no changes to vehicle premium
22 discounts, and does not propose any changes to service
23 or transaction fees, permit and certificate fees,
24 fleet rebates, or surcharges, or the discount for
25 aftermarket, and manufacturer or dealer installed

1 antitheft devices.
2 The breakdown by major vehicle class of
3 the overall average rate adjustment of 2.2 percent, as
4 proposed by MPI is as follows:
5 For private passenger, an overall
6 increase of 2.4 percent.
7 For the commercial class, an overall
8 increase of 2.4 percent.
9 For the public class, an overall
10 increase of .6 percent.
11 For motorcycles, an overall increase of
12 3.1 percent.
13 For trailers, an overall decrease of
14 4.7 percent.
15 And for off-road vehicles, an overall
16 decrease of 20 percent.
17 After consideration of insurance use
18 and territory, and capping and balancing for
19 experience rate adjustments, the results were modelled
20 by the Corporation to assess the impact of various
21 rate and classification changes.
22 In total, the vehicle population for
23 the year of the application is one million one hundred
24 and forty-nine thousand one hundred forty (1,149,140)
25 vehicles, to which the proposed rate would be applied

1 as follows:
2 Six hundred and one thousand three
3 hundred and twenty-four (601,324) vehicles, or 52.3
4 percent of the overall fleet would receive a rate
5 increase, the majority of which would be ninety-nine
6 dollars ($99) or less.
7 Four hundred and sixty-two thousand one
8 hundred and ninety-six (462,196) vehicles, or 40.2
9 percent of the overall fleet, would receive a rate
10 decrease.
11 And eighty-five thousand six hundred
12 and twenty (85,620) vehicles, or 7.5 percent of the
13 overall fleet, would receive no change in rates.
14 The Corporation's estimate of its
15 overall rate requirement is sensitive to the methods
16 and assumptions used in its derivation. Apart from
17 the introduction by MPI of the net Capital Maintenance
18 Provision with this year's application, the
19 Corporation indicated that no significant
20 methodological changes nor any changes in the basis of
21 selection of assumptions for the determination of the
22 rate indications were otherwise introduced this year.
23 Nevertheless, considerable attention was paid through
24 the interrogatory and hearing process to the matter of
25 interest rate forecasting, along with the new proposed

1 net Capital Maintenance Provision.

2 With respect to interest rate

3 forecasting, in this application, the Corporation has,

4 again, adopted a naive interest rate forecast, in

5 effect, assuming no change in market rates from

6 current levels, all linked to a Government of Canada

7 ten-year bond yield of 2.24 perc -- percent.

8 As the application was prepared in the

9 spring, the Application's original naive interest rate

10 forecast reflected market interest rates from that

11 time. Since the spring market, interest rates have

12 moved upward by 19 basis points, such that a

13 Government of Canada ten-year bond yields 2.43 percent

14 as at the end of September 2018.

15 Based on this update alone, and

16 continuing with a naive interest rate forecast, the

17 Corporation determined that the indicated rate

18 increase dropped from 2.2 percent to 1.8 percent,

19 including the net Capital Maintenance Provision.

20 The Corporation also provided an

21 estimate of the impact of instead forecasting interest

22 rates based on an average of the naive forecast and

23 the consensus of bank forecasts, the so-called 50/50

24 forecast. Based on market rates to the end of

25 September, 2018, the Corporation estimates its overall

1 rate requirement would fall to 1 percent, based on the
2 50/50 interest rate forecast.
3 In defence of its proposal to use the
4 naive interest rate forecast, the Corporation provided
5 a new statistical analysis comparing the bias and
6 efficiency of the naive forecast as compared to the
7 50/50 forecast, as well as the consensus bank
8 forecast. This analysis concluded that over the
9 recent historical period spanning the 2005 GRA to the
10 2018 GRA, the naive out -- forecast outperformed the
11 alternatives, showing less bias and less variance
12 compared to actual interest rates.
13 With respect to the Capital Maintenance
14 Provision, MPI has proposed a net Capital Maintenance
15 Provision, or a net CMP, to recognize the expected
16 return on investment assets supporting Basic total
17 equity, and to maintain Basic's capital position.
18 Specifically, the net CMP is designed such that --
19 that the minimum capital test ratio forecasted at
20 fiscal year-end 2019/'20 remains the same as the level
21 forecasted at fiscal year-end 2018/'19.
22 MPI proposes a net Capital Maintenance
23 Provision of 2.1 percent, which represents collecting
24 $22.6 million in 2019/'20, $23.6 million in 2020/'21,
25 and similar amounts in subsequent years, all assuming

1 continuation of the current proposed net CMP totaling
2 to approximately $96 million over the next four (4)
3 years to maintain Basic's capital position. The
4 Corporation indicated that it will review -- review
5 adjusting the level of the net CMP with each
6 successive GRA.
7 With respect to financial results, the
8 Corporation has provided to the Board its actual
9 financial results with respect to the 2017/'18 year,
10 as well as for the first six (6) months of the current
11 year, 2018/'19.
12 For the 2017/'18 fiscal year, Basic
13 incurred net income of $34.4 million, compared with
14 forecasted net income of $57.5 million at last year's
15 GRA, a negative variance of $23.1 million. This
16 negative variance was attributed by the Corporation to
17 an increase of $27.8 million in net claims incurred
18 cost, primarily due to higher write-down and deferred
19 policy acquisition cost, premium defic -- deficiency
20 than forecasted of $16 million, lower physical damage
21 claims of $34.8 million, and lower than forecasted
22 interest rates of $59.8 million.
23 Overall, there was a negative variance
24 of $37.6 million in underwriting results from that
25 presented last year. Offsetting this, the positive

1 variances were attributed, in part, to investment
2 income, which was $116.3 million, $14.5 million higher
3 than the $101.8 million forecast last year. The
4 higher level of investment income was attributable
5 primarily due to higher than expected alternative
6 investment income of $13.9 million.
7 With respect to the current year,
8 2018/'19, the subject of last year's GRA, MPI
9 forecasts for Basic a net loss of $21.3 million for
10 rating purposes revised to a net income of $135.6
11 million in this GRA. This positive change was
12 primarily due to higher than expected equity
13 investment income of $106.1 million, higher forecast
14 growth in interest rates of $16.7 million, lower
15 forecast for physical damage claims, $18.5 million,
16 and lower forecasted write-down deferred policy
17 acquisition costs, premium deficiency, $19 million,
18 which resulted in a forecast reduction in net claims
19 incurred of $47.1 million.
20 MPI filed its second quarter report as
21 MPI Exhibit Number 24. For the first six (6) months
22 of 2018/'19, the Corporation reported a net income of
23 $72.8 million, an improvement of $42.3 million from
24 last year for the same period. Of the $72.8 million
25 in reported net income, MPI reported $39.4 million

1 related to Basic, compared to a net income of $9.2
2 million for the same period last year, an improvement
3 of $30.2 million for the six (6) month period.
4 MPI reports that claims costs increased
5 by $5 million, or .9 percent, compared to last year
6 due to an increase of $11.8 million, or 4.1 percent in
7 physical damage claims incurred, offset by a decrease
8 of $5.6 million, or 3.2 percent in bodily injury
9 claims incurred. This increase in physical damage
10 claims was primarily due to a major hail event which
11 occurred June 14, 2018, which was mitigated by
12 reinsurance in the amount of $14.6 million. The $5.6
13 million increase in bodily injury claims was due to a
14 $22.5 million favourable interest rate impact on
15 unpaid claims, offset by an increase in direct claims
16 incurred by $25.7 million.
17 MPI reported that it was currently
18 ahead of its planned forecast for the 2018/'19 year,
19 based on results for the first six (6) months, due to
20 favourable claims experience. MPI forecasts net
21 income of $17.9 million for 2019/'20, and $17.7
22 million for 2020/'21, based on the proposed 2.2
23 percent applied for rate increase.
24 In establishing Basic rates, the Board
25 has stated in -- in the past that it looks to the

1 overall financial wellness of the Corporation. MPI's
2 Board of Directors directed that $37.3 million be
3 transferred from the Extension line of business to the
4 Basic Rate Stabilization Reserve, as at February 28,
5 2018, to raise the rate stabilization reserve, or RSR,
6 to $211 million. MPI reported that this transfer was
7 made to ensure that Basic total equity was above the
8 amount required for Basic to be in satisfactory
9 financial condition of $201 million as per the 2017
10 Dynamic Capital Adequacy Testing, or DCAT report.
11 This is the fourth -- the fourth
12 consecutive year in which the Board of Directors has
13 directed a transfer to the Basic rate stabilization
14 reserve. Prior transfers include $27.8 million in
15 2016/'17, $75.7 million in 2015/'16, and $72.7 million
16 in 2014/'15. The Corporation has, as of year-end
17 2017/'18, $352 million -- .6 million in retained
18 earnings, including 171 million in Basic, 100 and --
19 102.5 million in Extension, and $81.7 million in
20 Special Risk Extension, or SRE.
21 Overall corporate total equity as at
22 February 8, 28 -- February 28, 2018, including
23 accumulated other comprehensive income, was $399
24 million, of which $210.8 million relates to Basic
25 operations, 102.9 million to Extension, and 85.3

1 million to SRE.
2 With respect to the Rate Stabilization
3 Reserve and Dynamic Capital Adequacy Testing, by Order
4 162/'16, the Board approved the following definition
5 of the purpose of the RSR:
6 "To protect motorists from rate
7 increases that would otherwise have
8 been necessary due to unexpected
9 variances from forecasted results,
10 and due to events and losses arising
11 from nonrecurring events or
12 factors."
13 The Dynamic Capital Adequacy Testing,
14 or DCAT report, was prepared internally by MPI's chief
15 actuary, Mr. Luke Johnston, in accordance with the
16 Canadian Institute of Actuary Standards of Practice
17 and accepted actuarial practice in Canada. The DCAT
18 report reflects that Basic's future financial
19 condition will be satisfactory if, throughout the
20 forecast period, it is able to meet all its future
21 obligations under all plausible adverse scenarios, and
22 under the base scenario that it meets the minimum
23 regulatory capital requirement.
24 Based on this definition, Mr. Johnston
25 concluded that Basic's future financial condition is

1 satisfactory based on the proposed regulatory minimum
2 RSR target level of $143 million. The DCAT has been
3 prepared using a base -- base scenario financial
4 forecast consistent with that of the GRA, including
5 the use of a naive interest rate forecast, but
6 specifically excluding the net CMP, which the
7 Corporation believes should not be included.
8 With respect to the total equity target
9 capital range, in Order 130/'17, the Board stated that
10 it continues to favour scenario-based testing for the
11 setting of both the lower and upper Basic total equity
12 thresholds, including the iterative approach, which
13 has evolved from the collaborative process.
14 The Board ordered that the lower Basic
15 total equity threshold be set at $180 million, based
16 on the iterative mod -- modelling of a 1:40 year or
17 97.5th percentile scenario over a two (2) year time
18 horizon after routine management or regulatory
19 actions.
20 The Board further directed that the
21 upper threshold for Basic total equity be set at $325
22 million, established on the same basis.
23 Determination of the target range for
24 Basic total equity is based upon the risks facing
25 MPI's Basic insurance operations. MPI noted that

1 recent changes in how the Corporation manages
2 investments has significantly reduced the risk --
3 risks it faces. MPI put forward that applying this
4 methodology in the context of this year's GRA results
5 in a lower threshold of $120 million and an upper
6 threshold of $251 million.
7 In this GRA, the Corporation is seeking
8 approval for a low -- lower total equity threshold of
9 a 34 percent MCT, equivalent to a forecasted Basic
10 total equity balance of $143 million, based on a 1:40
11 year probability Dynamic Capital Adequacy Test adverse
12 scenario after routine management and regulatory
13 actions over a two (2) year time horizon.
14 The Corporation argues that the $143
15 million represents the lowest amount required for
16 satisfactory financial condition. In this regard, the
17 Corporation has deviated from the Board-approved
18 methodology set out in PUB Order 130/'17.
19 The Corporation also proposes a Basic
20 total equity target range with an upper threshold
21 based on a minimum capital test ratio of 85 percent,
22 which was determined to equate to a -- a forecasted
23 Basic total equity of $305 million based on a 1:40
24 DCAT adverse scenario, with no management or
25 regulatory actions over a two (2) year time horizon.

1 Assuming no management or regulatory
2 actions is a deviation from the Board-approved
3 methodology as set out in Board Order 130/'17. The
4 Corpor -- Corporation has calculated the lower and
5 upper Basic total equity thresholds based on modelling
6 before the inclusion of the proposed net Capital
7 Maintenance Provision. Since the CMP is intended to
8 maintain or adjust capital within the calculated
9 range, the Corporation -- Corporation believes its
10 inclusion in the target capital analysis would distort
11 the calculation of the Basic total equity targets and
12 reduce their consistency and stability.
13 The Corporation indicated that it will
14 be bringing forward a Capital Management Plan in the
15 2020 GRA. The Corporation anticipates that this plan
16 will include build-and-release provisions designed to
17 ensure that Basic would operate within the limits of
18 the established Basic total equity range. The
19 Corporation believes the introduction of a net Capital
20 Maintenance Provision in this application can be
21 introduced without a Capital Management Plan.
22 With respect to investment income in
23 the investment portfolio. The funds available for
24 investment are primarily unearned premium reserves and
25 unpaid claims reserves. The investment portfolio

1 supports both the payment of accident claims, as well
2 as the pension obligations of the Corporation. The
3 size of the Basic investment portfolio for the year of
4 the application is prese -- projected to be $2.45
5 billion for 2018/'19, growing to 2.93 billion in
6 2020/'23 -- pardon me, 2022/'23.
7 Historically, the Corporation's
8 investment income has been a major component of its
9 income, and has offset its annual underwriting losses.
10 Last year, total Basic investment income was
11 forecasted to be $101.8 million. Actual base --
12 actual investment income for Basic was $116.3 million
13 against an underwriting loss of $81.9 million, for a
14 net income of $34.4 -- 4 million. The positive
15 variance of $14.5 million in investment income from
16 forecast can be primarily attributed to higher than
17 expected real estate pooled fund returns.
18 In the current forecast, using a naive
19 interest rate forecast, corporate invested --
20 investment income is presen -- projected to be $223.5
21 million for 2018/'19, of which Basic's share is $191.8
22 million. Based on the September 30, 2018 naive
23 interest rate forecast of 2.43 percent for a
24 Government of Canada ten-year bond, which reflects an
25 increase of 19 basis points from the 2.24 percent used

1 in the GRA filing, the Corporation is now projecting
2 investment income of $171.4 million for Basic to
3 offset a revised underwriting loss now forecast at
4 $28.3 million. Net income for 2018/'19 is now
5 forecast to be $143 million. Investment income is
6 forecast to be $84.8 million in 2019/'20, offsetting
7 an underwriting loss of $65.9 million, for a net
8 income of $18.9 million for the year.
9 MPI is part of an Investment Committee
10 Working Group, which is comprised of representatives
11 of the Department of Finance and of the Corporation,
12 which prepares an annual work plan for the investment
13 fund, and annually reviews the investment policy
14 statement. The investment policy statement discusses
15 aspects of the Corporation's investment portfolio,
16 including investment policy, investment income,
17 investment rebalancing, and the retainer and
18 monitoring of extern -- external investment managers.
19 Mercer was retained by the Corporation
20 to assist with conducting an Asset Liability
21 Management, or ALM study. The ALM study was completed
22 in late 2017, and filed in this GRA.
23 Resulting from the ALM study will be
24 the separation of the Corporation's co-mingled
25 investment portfolio into five (5) unique portfolios

1 that back the Corporation's liabilities and surplus.
2 The transition into five (5) unique portfolios is
3 planned to occur at the end of Q4 2018/'19, with the
4 complete transition expected to be by Q4 2019/'20.
5 The five (5) unique portfolios include:
6 Basic claims, Basic rate stabilization reserve,
7 pension, extension and special risk extension.
8 The current allocation of 70 percent in
9 bonds and 30 percent in growth assets will be
10 effective until February 28, 2019 and the five (5) new
11 investment port -- portfolios will be effective after
12 February 28, 2019 as a result of the ALM study.
13 As a result of the implementation of
14 the changes arising from the ALM study, Basic net
15 income is forecasted to increase by $95 million in
16 2018/'19, primarily as a result of the realization of
17 accumulated other comprehensive income on equity
18 assets due to the separation of assets into unique
19 portfolios.
20 The new ALM strategy will require the
21 Corporation to liquidate all of its US holdings and
22 Canadian equity holdings in order to make the
23 necessary asset allocation changes required for the
24 five (5) distinct portfolios.
25 Total equity is forecasted to be lower

1 because investment asset returns are forecasted to be
2 lower with fewer growth assets.
3 The MCT, or Minimum Capital Test, ratio
4 will increase by roughly 16 percent at the end of
5 2018/'19, from 54 percent to 69 percent, due to lower
6 capital requirements on the Basic line of business
7 investment assets. These projections are based on a
8 naive interest rate forecast.
9 With respect to operating expenses,
10 total corporate expenses were $299.2 million in
11 2017/'18, and are forecast to grow to $301.7 million
12 in the current fiscal year. MPI forecasts total
13 corporate extended -- expenditures to be $298.8
14 million in 2019/'20 and $306.7 million in 2020/'21.
15 MPI's global corporate costs are to be
16 allocated among the insurance and non-insurance
17 categories of business and by automated -- automobile
18 insurance lines of business, so as not to give rise to
19 cross subsidies -- subsidization.
20 Costs are allocated to Basic through an
21 integrated cost allocation methodology, which was
22 approved by the Board in Order 157/'12. There have
23 been no material changes to the integrated cost
24 allocation methodology in this application.
25 Upon the completion of the allocation

1 process, expenses attributable to the Basic program
2 are ex -- are established for normal operations and
3 improvement initiatives. Total Basic expenses were
4 $231.1 million in 2017/'18 or 77.3 percent of
5 corporate expenses and are forecast to be $230.5
6 million in 2018/'19, 17 -- pardon me, 76.4 percent of
7 corporate.
8 Thereafter, Basic expenses are
9 forecasted to decrease to $226.6 million in 2019/'20
10 or 75.8 percent of corporate, and $233.3 million or
11 76.1 percent of corporate in 2020/'21.
12 Salaries and benefits are a major
13 component of the operating expenses of Basic,
14 representing over 58 percent of the total operating
15 expenses in the year of the application.
16 Since 2014/'15, the Corporation has
17 experienced a compound annual growth of salaries and
18 benefits of 2.6 percent with compensation that has
19 grown from $113 million in 2014/'15 to $124.4 million
20 in 2017/'18. Salaries and ben -- benefits are
21 forecast to be $130.5 million in the current year and
22 are forecast to be $133.5 million in 2019/'20.
23 MPI is now forecasting an increase in
24 compensation expenses, net a vacancy allowance, of
25 4.52 percent in 2018/'19 and an increase of 3.18

1 percent in 2019/'20.
2 Staffing for 2017/'18 was 1,878.1 full-
3 time equivalents overall and the Corporation is
4 projecting a staffing level of 1,902.5 full-time
5 equivalents for 2018/'19. Normal operations were
6 1,860.9 full-time equivalents in 2017/'18, and were
7 forecast to grow by 13.2 to 1,874.1 full-time
8 equivalents in normal operations. Initiatives
9 staffing levels increased from 14.7 full-time
10 equivalents to 18.5 full-time equivalents.
11 MPI reported in its Q2 report that its
12 actual staffing level for the first two (2) quarters
13 of this year was 1,762 full-time equivalents. MPI
14 indicated that it expects the level of staffing to
15 increase through the remainder of this year as it
16 fills vacancies. The Corporation builds into its
17 financial forecast a vacancy allowance to account for
18 staff turnover.
19 MPI's 2018/'19 budget and staff
20 complement includes 368.2 full-time equivalents to
21 support its infa -- IT infrastructure and projects, of
22 which 286.2 full-time equivalents are internal staff
23 and 82 full-time equivalents are external IT
24 contractors.
25 MPI has indicated that 20 positions

1 have been converted to date in its external labour
2 strategy, which plan to internalize 27 IT positions
3 over the 2016/'17 to 2019/'20 fiscal years. With this
4 approach, MPI expects to achieve between 2.4 and $3
5 million in annual savings.
6 With respect to capital expenditures,
7 MPI projected Basic capital expenditures to be $17.5
8 million for 2018/'19, $26.2 million for 2019/'20 and
9 $31.7 million for 2020/'21. So over $75 million in
10 the next three (3) years.
11 The majority of the capital expenditure
12 or $110.9 million, is an ongoing and future IT
13 projects, including the future IT project legacy
14 systems modernization, which relates to the
15 replacement of legacy systems at a budgeted cost of
16 $58.6 million.
17 The Board has heard at this hearing
18 that the -- that MPI has implemented a value
19 management process to support the need for capital
20 spending decisions.
21 MPI described this approach as a
22 cultural shift for the organization, where major
23 projects require a business case, including looking
24 internally at all costs and benefits for a project.
25 The mal -- value management process

1 identifies IT costs that are required to maintain the
2 functionality of software, licensing fees and insure -
3 - insurance costs as ongoing costs to support
4 operations.
5 MPI has created business cases for
6 business transformation office manage projects of
7 $500,000 or more in the 2018/'19 capital budget. As
8 part of its overall value management process review,
9 MPI wrote off $20.5 million in deferred development
10 projects, of which $18.5 million related to Basic
11 projects.
12 MPI reported the customer claims
13 reporting system component of the physical damage re-
14 engineering program was cancelled with a write-off of
15 costs of $15.6 million.
16 With respect to physical damage re-
17 engineering, Mr. Chuck Henry from Gartner appeared as
18 a witness with the Corporation on its information
19 technology, physical damage, re-engineering and value
20 management panel.
21 Mr. Henry presented Gartner's update of
22 the cost benefit analysis for the multi-year physical
23 damage re-engineering project. Gartner stated in its
24 report filed in last year's GRA that the initial
25 initiative was made up of five (5) programs and twenty

1 (20) projects within these programs. Eight (8) were
2 completed, seven (7) were cancelled after determining
3 they were not strategic and did not meet the business
4 case, and five (5) were restructured projects which
5 then comprised the remainder of the PDR program.
6 The overall budget remained unchanged
7 at $65 million and showed sustained benefits of $13
8 million and reflected a net present value of the
9 project as a positive $13.7 million.
10 MPI management undertook a review of
11 the physical damage re-engineering, or PDR project, in
12 early 2018, applying its value management process.
13 The Corporation restated the PDR costs and benefit
14 projections. The total budget of the physical damage
15 re-engineering project has changed to $57 million from
16 the originally projected $65 million, based on the
17 reduction in scope of the project.
18 The net present value reported by
19 Gartner last year at $13.7 million was revised to a
20 negative $49.9 million, based on the MPI re-evaluation
21 of the project costs and benefits.
22 With respect to benchmarking, Gartner's
23 evaluation of the Corporation's information technology
24 showed that MPI spends 63 percent of its IT budget on
25 personnel, versus 44 percent for its peers and that

1 MPI IT staff composition is 34 percent made up by
2 contractors, verses 17 percent for its peers.
3 MPI improved its overall maturity
4 rating from 3.42 in 2015 and '16 to 3.52 in 2016/'17.
5 The CIO scorecard, which was -- has
6 been used by Gartner in the past to assess MPI's
7 process maturity, has since been discontinued by
8 Gartner. The current recommendation for IT maturity
9 assessments is Gartner's IT score. In 2016/'17 MPI's
10 overall maturity level was assessed by Gartner at 3.1,
11 using the IT score methodology.
12 The Corporation presented its
13 information technology strategy for 2018/'19. In it
14 the Corporation indicated that significant changes and
15 practices have been adopted moving forward. In
16 particular, six (6) main streams were discussed that
17 were changed from the prior technology approach:
18 Move toward proven technologies;
19 Identify all risks of a project prior
20 to project initiation;
21 Use of a project sponsor;
22 Align where possible to industry best
23 practices in vendor provided software;
24 Have the net value management process
25 become ingrained in MPI culture and the project life

1 cycle;
2 And create IT capabilities to support
3 business capabilities to solve a business objective.
4 With respect to road safety spending,
5 MPI is forecasting to spend $12.7 million in Basic
6 road safety and loss prevention programs in 2019/'20.
7 The largest component is spent on driver education,
8 including the high school driver education program,
9 which is approximately $3.9 million, or 31 percent of
10 the overall budget.
11 Impaired driving prevention strategies
12 are the second last -- second largest expenditure at
13 $2.3 million, or 18 percent of the overall budget.
14 Auto crime prevention strategies are forecast at $0.7
15 million, or 5 percent of the overall budget. The
16 balance of the road safety programs are advertising
17 and sponsorships, road safety programming and
18 RoadWatch, which is increased enforcement.
19 MPI has discontinued the immobilizer
20 program for 2019/'20 as a result of all new vehicles
21 now having built-in electronic immobilizer technology.
22 MPI estimates the savings related to the
23 discontinuation of this program to be $1 million.
24 MPI also discontinued the entry-level
25 professional truck driving training course, which

1 reimbursed individuals for taking the professional
2 truck driver training. MPI reported that it cancelled
3 the program with the support of the Manitoba Trucking
4 Association because the framework was well established
5 and funding was available from other sources.
6 Mr. Chair, members of the panel, I have
7 attempted to comment on the main issues that arose
8 this year. I would like to thank MPI and the
9 Intervenors for their cooperation extended throughout
10 this hearing, and this concludes my submissions.
11 Thank you.
12 THE CHAIRPERSON: Thank you, Ms.
13 McCandless.
14 We're going to adjourn until one
15 o'clock, when MPI will present its submission. I
16 would indicate that there will be a -- I will be
17 making a short statement at the beginning in -- in
18 relation to Mr. Ward Keith, who is resigning at the
19 end of this year but we'll adjourn until one o'clock.
20 Thank you.
21
22 --- Upon recessing at 11:48 a.m.
23 --- Upon resuming at 1:27 p.m.
24
25 THE CHAIRPERSON: Good afternoon.

1 Before we start with the submission of MPI, I'd like
2 to say a few words on behalf of the Board to Ward
3 Keith, who is, we understand, retiring from MPI at the
4 end of the year and is appearing on behalf of MPI
5 before the Board for the last time.
6 Some thirty-four (34) years ago, Ward
7 started in the mail room of MPI. At the end of this
8 year he will retire as vice-president. Ward gained
9 tremendous experience climbing the MPI corporate
10 ladder: Ten (10) years in the bodily injury claims
11 department, staff trainer for the personal injury
12 protection plan, member of the Autopac online
13 implementation team, manager of strategic
14 relationships with insurance brokers, director of
15 customer service, member of the executive team as
16 executive director driver safety and regulatory
17 control, as well as registrar of motor vehicles.
18 Finally, the vice-president Business Development and
19 Communications and Chief Administrative Officer for
20 MPI.
21 He was the go-to person for the tough
22 assignments, the trusted advisor, the humble colleague
23 and transformative leader. Ward has been recognized
24 for his achievements by other organizations including
25 the Canadian Council of Motor Transport Administrators

1 and the American Association of Motor -- Motor Vehicle
2 Administrators as Manitoba's chief representative.
3 MADD Canada presented him with a
4 Citizenship Distinction Award for his dedication to
5 road safety and loss prevention. He was also the
6 president of the Insurance Institute of Manitoba.
7 Ward has been actively involved within the community
8 through a number of voluntary positions at the United
9 Way and as a fundraiser for cancer research.
10 While I was in private legal practice,
11 which some days feels like a generation ago, I was
12 involved in the introduction of two (2) major projects
13 with Ward: CARFAX and Slingshot, both involved new
14 initiatives. There was no template. So we started
15 from scratch. Throughout both initiatives, Ward was
16 always forthright, he set out realistic targets and
17 found a way for MPI to introduce the initiatives
18 within a reasonable timeframe.
19 It was a consummate pro and someone I
20 learned could be trusted. Ward's word has always been
21 his bond.
22 Ward, on behalf of the Public Utilities
23 Board of Manitoba, I would like to thank you for your
24 ongoing dedication to MPI and for your service to the
25 people of Manitoba. We wish you great health and

1 happiness as you enjoy the fruits of your labour in
2 the many years ahead. Thank you.
3 If you have -- please, if you got any
4 words.
5 MR. WARD KEITH: If I can, thank you,
6 Mr. Gabor. First of all, thank you for those very
7 kind words. You know, in the thirty-four (34) years
8 that I've been with MPI I've had the real privilege of
9 being involved in a number of strategic initiatives
10 that have helped to define the organization and the
11 value that the organization brings to Manitobans, and
12 I'm talking about value both in terms of the products
13 and services that we provide, but also in terms of our
14 broader involvement with stakeholders when it comes to
15 road safety and loss prevention and keeping our roads
16 as safe as possible.
17 And as -- as part of this process for
18 many years, I truly do believe that the value that
19 Manitoba Public Insurance brings under this public
20 insurance framework that we have here has been not
21 only validated but often enhanced as a result of the
22 overview of this Board and the involvement of people
23 like Mr. Oakes on behalf of CMMG and Dr. Williams on
24 behalf of the CAC. So, for that I thank you for your
25 kind words. I thank you and -- for letting me part --

1 be part of this entire process. I thank you for that
2 as well. It has truly been one (1) of the highlights
3 of my career. Thank you.
4 THE CHAIRPERSON: Thank you very much,
5 sir. We appreciate it.
6 Mr. Scarfone, tough act to follow.
7
8 FINAL SUBMISSIONS BY MR. STEVE SCARFONE:
9 MR. STEVE SCARFONE: Yes. When I
10 signed up for this, I did not realize that this would
11 be the case, but yes.
12 So, Mr. Chairperson, we are ready to
13 proceed with MPIC's closing submissions for the 2019
14 General Rate Application. Just before doing so just
15 to formalize things, MPIC Exhibit 50 will be the
16 written closing argument and the slide deck that is up
17 before you on the screen will be marked as MPI Exhibit
18 Number 51.
19
20 --- EXHIBIT NO. MPI-50: MPIC'S closing submissions
21 for the 2019 GRA.
22
23 --- EXHIBIT NO. MPI-51: PowerPoint Presentation
24
25 MR. STEVE SCARFONE: And so before

1 beginning, Mr. Chair and panel members, I just want to
2 remind the panel that there are, in fact, these two
3 (2) presentations, the slide presentation was -- as
4 you might expect put together in a rather accelerated
5 manner, so, we encourage the Board to turn their
6 attention to the written submission, but the slide
7 deck will, as you might expect, hit the high points,
8 if you will, with some commentary by myself and Mr.
9 Guerra along the way.
10 But the written closing is the one that
11 we encourage the Board to -- to read and deliberate
12 upon.
13 So the second slide, please Ms. Hubert
14 (sic). So, we're going to begin by going through a
15 framework -- just past the introduction, Kristen,
16 please. Going through the -- the framework for the
17 2019 general application. When I say "the framework,"
18 it sets out really what Ms. McCandless identified in
19 her closing remarks, and that is, what the Corporation
20 is seeking in this year's General Rate Application. I
21 think we're all familiar with that. the .1 percent
22 rate increase, the 2.1 percent for a net Capital
23 Maintenance Provision, the RSR targets the Corporation
24 is seeking, 85 percent MCT, and lower target of 34
25 percent MCT.

1 We're asking that the Board make a
2 finding that the naive interest rate forecast should
3 be the methodology used in -- in forecasting interest
4 rates if -- wherever they might to be forecasted and
5 there's a couple of situations where that applies and,
6 of course, we're asking that the interim vehicle for
7 hire rates, that Order that was issued earlier, be
8 finalized on -- on -- on a final basis.
9 That the Board knows that there was an
10 updating of the --of the rate indication that was the
11 result of a PreAsk and as of September 30th, 2018,
12 there has been an adjustment to the rate indication
13 whereby there is now a .2 percent -- .26 percent
14 decrease in rates and the net Capital Maintenance
15 Provision has been accordingly adjusted to 1.80
16 percent.
17 The targets have adjusted as well as a
18 result of the -- the updated interest rate figure.
19 The upper target is now $315 million, and that's 88
20 percent MCT. The Corporation would like to emphasize
21 that this particular target makes use of the PUB
22 approved methodology.
23 The Corporation would also emphasize
24 that, as you've heard, Mr. Chair, the Corporation does
25 not agree with the methodology used, but has made use

1 of the -- the Board approved methodology as directed.
2 The Corporation, of course, is
3 ultimately seeking to have in place 100 percent
4 minimal capital target rates, which MPIC believes is
5 the best insurance practice for the industry.
6 And we maintain that the naive interest
7 rate forecast should apply, but of course, that's
8 based on the Government of Canada ten-year bond yield.
9 And next slide, please.
10 So the first point there is -- is the
11 just and reasonable rate requirement that MPIC must
12 bring before this Board and, of course, which the
13 Board if -- if it accepts would MPIC has proposed will
14 approve.
15 The net Capital Maintenance Provision
16 we say will result in greater stability,
17 predictability and less volatility for Manitobans.
18 The Corporation says that the approach is accurate and
19 fair.
20 The Rate Stabilization Reserve, Mr.
21 Chair, sets the targets using the collaborative DCAT
22 approach, the Dynamic Capital Adequacy Testing
23 approach. And those targets we say are based on best
24 estimates and are important to maintain prudent fiscal
25 management across the Corporation. The Corporation in

1 short, demands adequate capital for its operations.
2 The interest rate forecasting issue,
3 Mr. Chair, was a big issue again this year. There was
4 a lot of discussion about the naive interest rate, the
5 50/50 forecast methodology, the standard interest rate
6 forecasting methodology. MPIC, as Mr. Johnston has
7 indicated, believes that the naive forecast is the
8 best estimate for setting rates, and that's because it
9 allows the Corporation to base its forecasts on
10 unbiased interest rate forecasting.
11 We say the 50/50, as ordered by the
12 Board last year, is not a compromise. We have shown
13 evidence that it is biased and inaccurate over the
14 past number of years and has cost the Corporation
15 millions of dollars when departing from the naive.
16 And lastly, the Bank of Canada
17 overnight rate we say is not a proxy for the
18 Government of Canada ten-year bond yield, which is
19 what the Corporation uses in its forecasting.
20 I'll also speak to the area of
21 investments. We've heard a lot of evidence in the
22 last couple of days about how MPIC has moved away from
23 a co-mingled portfolio and is now using segregated
24 portfolios, five (5) separate buckets of portfolios,
25 including the Basic portfolio. The investment

1 decisions that were made were done so by a government
2 appointed Board of Directors on which certain experts
3 sit as part of an investment committee, and moreover,
4 it was informed by the results of an independent study
5 that was ordered by this -- by this Board, the Mercer
6 Group.
7 The next bullet point there, Mr. Chair,
8 is an important one. Basic -- the Basic portfolio,
9 plus the low capitalization that we say exists and is
10 a continuing problem for MPIC, along with the historic
11 losses that we've made the Board aware of time and
12 again has equalled no appetite for risk, where it
13 concerns investments.
14 Yesterday you -- you would've heard Mr.
15 Viola suggest that the losses, the net income losses
16 the Corporation has experienced in the past number of
17 years should not have been a factor in their
18 investment strategy. He said the Corporation should
19 only look forward in making its investment decisions.
20 I would suggest to you, Mr. Chair, that
21 an outside observer would disagree with that and would
22 fully understand the Corporation's risk aversion, if
23 you will, given the millions of dollars -- hundreds of
24 millions of dollars the Corporation has lost over the
25 past four (4) or five (5) years. And so that why --

1 is why we say there that it equals no appetite for
2 risk.
3 And then lastly, the investment
4 strategy, as we've seen, will result in a change in
5 the risk profile of Basic and the amounts in the RSR
6 have been accordingly reduced by about 30 percent. So
7 the strategy has shown immediate positive results as
8 it concerns the capital that the Corporation requires
9 on an ongoing basis. Next slide, please.
10 Following my investments, Mr. Guerra
11 will speak to revenues, expenses and ratemaking and
12 he'll also speak to information technology, so I'll
13 just leave those two (2) topics that for my colleague
14 to the speak to. Next slide, please.
15 And as well as the vehicles for hire
16 and any ongoing topics that Mr. Guerra wants to
17 canvass with the Board in closing. Next slide,
18 please.
19 Just and reasonable rates. In the
20 closing written submission, there's more comprehensive
21 detail for the Board to consider under what MPIC
22 characterizes as the new statutory framework that's in
23 place. This, MPI says, is the first general
24 application under this new framework and include
25 consideration to two (2) statutes, one (1) of which is

1 the Manitoba Public Insurance Corporation Act, that's
2 not new, but the Crown Corporations Governance and
3 Accountability Act is and those two (2) statutes, if
4 you will, work in concert, MPIC says, along with the
5 Board of Directors for Manitoba Public Insurance.
6 So those Acts define the roles for MPI
7 and its Board to establish and maintain reserves;
8 that's an important mandatory provision under MPIC's
9 home statute. Section 18 would say that the
10 Corporation shall establish and maintain adequate
11 capital reserves.
12 Secondly, those two (2) statutes and
13 the Board make and introduce new rates and changes and
14 that's pursuant to Section 25(1) of the Crown
15 Corporations Governance and Accountability Act.
16 And lastly, you'll see there that the
17 Crown Corporation Governance and Accountability Act
18 also defines the role of the Public Utilities Board
19 under that same subsection.
20 The -- the Act defines the role of the
21 Public Utilities Board to review applications for new
22 rates and changes to existing rates and, of course,
23 the Act also sets out that the Public Utilities Board
24 must approve a just and reasonable rates. Next slide,
25 please.

1 And there, sir, is the provision that
2 the Board I'm sure is well familiar with that sets out
3 the -- the approval process and the mandate that
4 Public Utilities Board has when considering MPIC's
5 rate application. But the second bullet point we say
6 is important because MPIC and the Public Utilities
7 Board, in MPIC's view, have distinct but complementary
8 roles to play to ensure the success of the Basic
9 compulsory insurance program.
10 What makes rates just and reasonable?
11 The Crown Corporations Act under Section 25(4)
12 provides a list of suggested considerations. We --
13 that there must be a balance between the impact of
14 rate increases on consumers with the fiscal health of
15 the Utility.
16 Lowest rates are not always just and
17 reasonable. We must also consider the impact of
18 unstable rates, i.e., rate shock. And there was some
19 evidence canvassed on what exactly that might mean,
20 but I think everybody is -- is in agreement that this
21 Board and MPIC should do what it can to avoid rate
22 shock. And that, we would say, would include having
23 the Corporation properly capitalized.
24 MPIC makes rates that it considers to
25 be just and reasonable and the General Rate

1 Application balances the interests of ratepayers with
2 MPI's requirement to cover the cost of the 2019/2020
3 policies. And this, as the slide, indicates is where,
4 with all due respect, we say that the Intervenors fall
5 short.
6 The positions advanced by the
7 Intervenors often times do not strike this balance and
8 recommendations are -- are usually made that focus
9 only on reducing rates. And -- and just before we
10 move to that next slide, we did hear evidence in this
11 proceeding, Mr. Chairperson, from Andrea Sherry and
12 she confirmed on cross-examination that she has never
13 before appeared before this Board and made a
14 recommendation for either increased capital or
15 reduction in the rate indication.
16 And we say that part of the difficulty
17 that the Corporation has with the evidence, in
18 particular of -- of Ms. Sherry, is that although she
19 was qualified to give opinion evidence as an expert
20 before this tribunal, she appeared to be advocating
21 and, that is, she would make reference during her
22 submissions to arguing for this or arguing for that.
23 And I would argue that the Corporation doesn't need
24 capital.
25 With all due respect to Ms. Sherry, her

1 role before this Board is not to argue. Her role is
2 to present the facts that this Board needs to
3 determine what's just and reasonable for the
4 Corporation. And so we would suggest that to the
5 extent that the Board is going to rely on her
6 evidence, it do so with some caution and perhaps give
7 it not as much weight as -- as the evidence heard from
8 some of the other witnesses in the proceeding.
9 The Crown Corporations and Governance
10 Act also requires MPIC to prepare an annual business
11 plan. This is part of the statutory framework that I
12 referred to earlier, Mr. Chair, and it's mandatory.
13 The Corporation has to prepare the annual business
14 plan. The business plan is approved by the Minister
15 responsible for MPIC and it's a roadmap for the
16 achievement of Mission Statement objectives.
17 As you heard from Mr. Graham a couple
18 weeks ago, MPIC has a new Mission Statement and that
19 is to provide exceptional coverage in service,
20 affordable rates and safer roads through public
21 automobile insurance. The direction for this plan, if
22 you will, or for this direct -- or for this new
23 Mission Statement is set by the MPIC Board of
24 Directors and approved by the Government of Manitoba.
25 Some key priorities of MPIC, as defined

1 by the annual business plan. The first and most
2 important of which and -- and you've heard this
3 refrain for the past number of years, is to make the
4 Basic program self-sustaining. And that, of course,
5 in our view, goes directly to the Corporation's
6 reluctance to have continued capital transferred from
7 the other lines of business. That, the Corporation
8 would say, is not in line with having Basic self-
9 sustained.
10 Some of the other key priorities of MPI
11 as set out in the Annual Business Plan include the
12 establishments of rates in accordance with AAP,
13 Accepted Actuarial Practice, to keep Basic rates
14 stable, predictable and affordable. That is a clear
15 mandate from the Government of Manitoba. Evolve
16 products and services to meet the needs of Manitobans
17 and not to impair the consolidated financial statement
18 of Manitoba.
19 Other key priorities are capital
20 projects and IT initiatives that support the core
21 business function. You heard evidence from Mr. Graham
22 that there will be a transition of sorts; that the
23 Corporation will go back to its core business
24 functions of providing insurance products and driving
25 services. They will not be engaging in risky

1 information technology programs to the extent that
2 they don't support the core business functions.
3 And, lastly, the annual business plan
4 would say that the Corporation has to continue to
5 demonstrate fiscal prudence and you'll hear from Mr.
6 Guerra on this point, but the expenses evidence that
7 was advanced and tested at this hearing, I think,
8 would support the contention that the Corporation has
9 continued to demonstrate fiscal prudence on that
10 front.
11 The new relief being sought in this
12 year's Application is called the Net Capital
13 Maintenance Provision. There's a lot of evidence
14 heard, a lot of questions asked about what the CMP is.
15 The Capital Main -- Maintenance Provision, Mr. Chair,
16 is an additional amount collected from ratepayers to
17 maintain the capital level of Basic in a particular
18 fiscal year.
19 And for the purposes of this
20 Application, it's the fiscal year beginning 2019/2020.
21 Treated separately by MPI from the breakeven rate
22 indication, MPIC considers what is needed after
23 factoring in income earned on the Rate Stabilization
24 Reserve, the investments, the investment income
25 specifically from the Rate Stabilization Reserve.

1 So you'll see there, the -- the -- the
2 CMP proposal and how it result -- results in the --
3 the initial rate indication that was sought when the
4 Application was filed in June.
5 There was a 3.3 percent increase needed
6 to maintain the capital in 2019/2020, but from that
7 the interest or the investment income that was earned
8 on the RSR was subtracted to come up with what Mr.
9 Johnston refers to as the net Capital Maintenance
10 Provision.
11 And this year, Mr. Chair, will
12 appreciate that the ratepayers are, in fact, seeing
13 the benefit of the investment income from the Rate
14 Stabilization Reserve. Last year the Corporation was
15 before this Board asking that -- that income not be
16 offset against rates and that MPIC be allowed to
17 retain the RSR investment income to build the RSR;
18 that is not reflected in the application this year.
19 In fact, you can see before you that but for making
20 use of that investment income, there would be a 3.3
21 percent ask, if you will, for a Capital Maintenance
22 Provision.
23 And these numbers you'll see below
24 there is based on the September 30th, 2018 Government
25 of Canada ten-year bond yield and that has

1 accordingly, as I set out at the beginning, reduced
2 the CMP to 1.8 percent.
3 This particular paragraph for Order or
4 Directive from last year's Order, Mr. Chair, was --
5 was repeated throughout the Application and you have
6 it there before you. But MPIC took this to mean that
7 the -- the Board last year recognized that without
8 some type of provision in place to prevent the
9 depletion of capital, that the RSR would continue to
10 decline, all else being equal, with the continued
11 growth of the Corporation.
12 I spoke of Ms. Sherry's evidence
13 concerning the net Capital Maintenance Provision.
14 Firstly, it's important to remember that Ms. Sherry
15 comes from the private insurance world where her
16 company has profit provisions in place that would help
17 maintain, perhaps even build, capital reserves.
18 Ms. Sherry testified that in her
19 opinion MPIC does not need a Capital Maintenance
20 Provision. She said that if MPIC holds capital within
21 the Rate Stabilization Range, it is adequately
22 capitalized. She said that if MPIC needs capital, it
23 can come back here year after year and simply seek a
24 rate increase which is precisely what the mandate of
25 the Board of Directors is not, and that is, to have

1 the Corporation impose upon its customers what might
2 be characterized as rate shock, depending on what
3 events might present themselves to MPIC in the future.
4 That is not best practices, in our
5 view, and the Corporation says they do, in fact, need
6 capital and that would avoid the rate increases that
7 Ms. Sherry has advanced as a -- as a solution to the
8 problem.
9 And Ms. Sherry also testified that, and
10 incorrectly claimed, that the Capital Maintenance
11 Provision builds RSL -- RSR capital until it exceeds
12 the upper target; that, we say, is contrary to the
13 evidence that Mr. Johnston provided and ignores the
14 purpose of the Rate Stabilization Reserve which, as
15 I've said, is to prevent rate shock.
16 And I might add before we move to the
17 next slide again, and I don't mean to take aim at Ms.
18 Sherry, but her evidence seems to display a
19 fundamental misunderstanding of Manitoba Public
20 Insurance's rate application, generally speaking. And
21 -- and I say that for a couple of reasons, but I'll
22 provide one (1) example.
23 You may remember her testimony or her
24 report wherein she recommended that the end of her
25 report, she made three (3) recommendations. The

1 second recommendation made by Ms. Sherry was that, and
2 I'm quoting from the report:
3 "The DCAT methodology should be used
4 to set the Rate Stabilization
5 Reserve range."
6 That was the recommendation that she
7 was making to this Board; that the DCAT methodology be
8 used to set the RSR range. That is precisely what the
9 Corporation has done throughout its entire
10 Application.
11 You heard evidence from Mr. Johnston
12 the DCAT was used, the targets were set, the RSR range
13 was -- was established, and then as -- as you heard
14 from Mr. Johnston, converted to a minimum capital test
15 percentage. But the DCAT was never abandoned through
16 this entire exercise. Mr. Johnston relies on it
17 exclusively in establishing targets.
18 So for Ms. Simpson (sic) to suggest
19 that we use the DCAT -- or Ms. -- Ms. Sherry. Thank
20 you. From -- for Ms. Sherry to suggest that we use
21 the DCAT to establish the RSR range, in my view, as
22 I've said, it shows a fundamental misunderstanding of
23 -- of the of the application.
24 The Corporation says that a Capital
25 Maintenance Provision is accurate and fair, accurate

1 in that it determines the capital required to maintain
2 Basic in the rating year. And you heard Mr. Johnston
3 say it's fair, because the policyholders at the end of
4 the year -- at -- or, sorry, end the year with Basic
5 having the same capitalization as it did at the start
6 of the year. The policyholders in this year are the
7 ones who pay for the capital maintenance requirements
8 of that year, and that to me, and to Mr. Johnston, and
9 to the Corporation, seems eminently fair.
10 There was some consideration to --
11 perhaps -- next slide, please, Ms. Schubert. There
12 was some consideration, perhaps, to making use instead
13 of the approach taken by the Saskatchewan Government
14 Insurance on capital; that approach, we say, is -- is
15 more complex. It has a five (5) year forecast versus
16 a one (1) year forecast that's being proposed by
17 Manitoba Public Insurance, and is less fair to the
18 customers, in our view, than the Manitoba model. The
19 ratepayers are not paying the full cost to maintain
20 capital in that year, and the growth in the business
21 is not static.
22 In short, the outlook in the
23 Saskatchewan model is too long. And so to the extent
24 that Ms. Sherry said, We're back here every year, that
25 is, in fact, how we are different from Saskatchewan

1 Government Insurance. We're back on a yearly basis,
2 and any adjustments that need be made that can be made
3 on a yearly basis.
4 On the Rate Stabilization Reserve, as
5 I've just indicated, Mr. Johnston uses the Dynamic
6 Capital Adequacy Test to establish the Rate
7 Stabilization Reserve targets. The targets reflect
8 the results of a collaborative process that was in
9 place -- or that was entered into a couple years ago,
10 as I understand it. And MPIC, to be clear, is not
11 asking the Public Utilities Board to replace the
12 Dynamic Capital Adequacy Test with the minimum capital
13 test.
14 The DCAT produces a dollar value for
15 each target, which MPIC then expresses as an MCT
16 ratio. Converting the -- the monetary targets from
17 the DCAT to the MCT allows Mr. Johnston and MPIC to
18 forecast more accurately. The MCT, we say, is simple,
19 objective, and it works, and it's industry wide.
20 The Rate Stabilization Reserve targets
21 must be based on best estimates. The lower target
22 must be minimum for satisfactory financial condition,
23 and it's obviously of more concern than the upper
24 target, because falling below that target, as we've
25 seen, results in the actuary requiring a transfer of

1 capital from the Extension line of business to
2 maintain the Corporation in satisfactory financial
3 condition.
4 The Corpor -- the Corporation says the
5 current approach of the Public Utilities Board is not
6 based on the best estimate, and with all due respect,
7 sets the Rate Stabilization Reserve at a lower target,
8 too low, and -- and we saw the result of that last
9 year with a further transfer as directed by the MPIC
10 Board of Directors.
11 Basic remains the most thinly
12 capitalized insurer in Canada; that proposition was
13 put to Dr. Simpson last year, and he didn't deny it.
14 You may recall, Mr. Chair, his response, I believe
15 was, Well, that's not necessarily such a bad thing.
16 Well, the Corporation vehemently disagrees with that
17 assertion.
18 The rate stabilization range remains
19 below the level of MPIC's peers, and if MPIC were a
20 private insurer, it would be insolvent. And it's
21 important to remember, Mr. Chair, that but for the
22 $214 million that were transferred from the Extension
23 line of business, there would be no money in the Rate
24 Stabilization Reserve except for the 12 million that
25 this Board saw fit to allow MPIC to keep last year.

1 MPIC does not seek 100 percent minimum
2 capital target upper RSR target, and does not ask to
3 be treated like a private insurer. MPIC seeks rate
4 stabilization targets to ensure that it is adequately
5 capitalized, and this, the Corporation says, is
6 prudent fiscal management.
7 Before I -- I move on to rate -- before
8 interest rate forecasting, I just wanted to add about
9 capital, Mr. Chair, that it seems to me, and I've said
10 this, you know, about trials and hearings of this
11 nature, that when you do them, you soon realize what
12 the main issue is. And I said in my opening statement
13 that the story that MPIC would be presenting here in
14 the past three (3) weeks was one of capital. Capital
15 is the story. And there's a number of issues that
16 were canvassed during this hearing that all revolve
17 around capital.
18 Interest rate forecasting, you know, we
19 can debate again and again whether the naive, or the
20 50/50, or the SIRF is the appropriate forecasting
21 model. But if the Corporation had sufficient capital
22 in place, it might be willing to concede that interest
23 rates are forecasting to rise, and -- and accept,
24 perhaps, a 50/50 model.
25 But as it stands, you've heard Mr.

1 Johnston say, We're not prepared to take that bet,
2 given the net income losses that the Corporation has
3 suffered based on improper and inaccurate interest
4 rate forecasting. So that, we say, capital would --
5 would deal with that -- with that issue once and for
6 all.
7 Investments. You've heard a lot of
8 evidence in the last couple days about how the
9 Corporation has adopted a low risk tolerance in its
10 new investment strategy. And the result of that is
11 not lost on the Corporation and the impact that has on
12 its ratepayers.
13 And you heard evidence from Mr. Bunston
14 that the projected returns under the new investment
15 strategy have lowered, where before, we used to
16 project returns of 4.29 percent, under the new
17 investment strategy, the returns are now forecasted to
18 be 3.12 percent, more than a hundred basis points.
19 And so with low risk comes low returns.
20 There's no growth assets in the Basic portfolio
21 anymore. And so we see that reflected in the returns
22 that are forecasted under the new investment strategy.
23 I would suggest to you, Mr. Chairperson, that if the
24 Corporation had proper capital in place, it might be
25 willing to have more growth assets in its Basic

1 portfolio, but as we've heard in the last couple days,
2 that's simply not at the direction from the Board of
3 Directors. And it's enticed -- it's -- it's comprised
4 entirely of fixed income as a result, no equities.
5 On the DCAT, if the Corporation was
6 properly capitalized, I would suggest that Mr. Luke
7 would no longer have to make use of a modified Dynamic
8 Capital Adequacy Test; that is, he wouldn't have to
9 assume capital transfers from the Extension line of
10 business. So some of the issues that surround the
11 DCAT and its modelling would go away as well.
12 And lastly, on the Rate Stabilization
13 Reserve, there would be no further capital transfers
14 from the Extension line of business. And again, it
15 bears repeating, $214 million over the past four (4)
16 years have been transferred from the Extension line of
17 business.
18 And, Mr. Chair, you asked Mr. Graham,
19 well, what -- what would MPIC be doing with that
20 money? Well, perhaps, as described by Mr. Graham, it
21 would result in cheaper Extension products for
22 Manitobans; that would be one (1) result that Mr.
23 Graham envisioned. But again, if -- if the
24 Corporation was properly capitalized, the Rate
25 Stabilization Reserve, we say, wouldn't be an ongoing

1 issue. The targets would be set, and the MPIC would
2 do what it needs to to stay within that range.
3 And -- and on that, we'll move to
4 interest rate forecasting.
5
6 (BRIEF PAUSE)
7
8 MR. STEVE SCARFONE: The Corporation
9 wants to ensure that there's this distinction drawn
10 between the two (2) forecasting benchmarks, if you
11 will. I don't know quite the right terminology to
12 use, but the -- the rates that MPIC presents to this
13 Board and all the forecasting measures that Mr.
14 Johnston takes are based on the Government of Canada
15 ten-year bond yield. It is not a prediction of what
16 the Bank of Canada's overnight lending rate will be,
17 and that refers to the interest rate hike that we
18 heard a lot of evidence about from last week. That is
19 not what MPIC's forecasts are based on, and they are
20 not, in the Corporation's view, interchangeable.
21 And they can -- you heard a lot of
22 evidence back and forth about whether there's some
23 correlation between the two (2). MPIC would say there
24 isn't, especially over the short term. The
25 Intervenors would say there absolutely is. But in our

1 view, they're not interchangeable, and it's the
2 Government of Canada ten-year bond yields that matters
3 for this Board, in our view.
4 Next slide, please. Some of the
5 lessons learned is that forecasting interest rates is
6 hard to do. It's impossible to do it accurately, and
7 we're bound to get it wrong. And you heard Mr.
8 Johnston say that, quite candidly, a couple of times
9 during this proceeding. We're going to be wrong. We
10 are going to be wrong. Nobody gets these things
11 right. None of us are clairvoyants, and there's a
12 quote there from the cross-examination of Dr. Simpson,
13 and he, too, candidly admitted, no idea what interest
14 rates will be on September 1, 2019. They may go up.
15 They may go down.
16 The difficulty that MPIC has is that
17 future ratepayers will pay if we forecast wrong. And
18 there's that number again, often repeated, the losses
19 that occurred as a result of basing our forecasts on
20 the SIRF, and interest rates didn't rise as the banks
21 predicted. And those losses, as we've heard, depleted
22 the rate stabilization reserve, and the impact of rate
23 stability, predictability, and volatility, and they
24 made the Basic program less self-sufficient.
25 The three (3) forecasting options are

1 set out there, and as you well know, MPIC is of the
2 view that the naive interest rate forecast is the best
3 forecast, and offers the less -- the least amount of
4 speculation going forward. You go with what you know,
5 is essentially the message there. It also impacts or
6 has an influence on how much MPIC needs to collect
7 from its ratepayers to break even. That's important.
8 That's why we're all here.
9 We need to figure out what rate is
10 indicated to allow for break-even ratemaking. And it
11 also influences the targets that are to be set for the
12 Rate Stabilization Reserve. And lastly, as we've
13 seen, and it's not listed there, it impacts upon the
14 forecasting of how much investment income the
15 Corporation can expect to receive.
16 Standard Interest Rate Forecast, or the
17 SIRF, uses forecast of the five (5) major banks. It
18 uses a mean reversion model, considers economic
19 factors, and you know where I'm going to go, here. It
20 has a history of being biased and being wrong.
21 And the 50/50 interest rate forecast
22 awaits the results of the SIRF, and the naive, and is
23 a compromise of sorts, but only half as accurate as
24 the naive, the results would show. And recent
25 history, as we've heard, would suggest that it

1 performs worse than the Standard Interest Rate
2 Forecasting methodology.
3 And so there's that slide which Mr.
4 Crozier calls the spaghetti graph, but it's important
5 to know what this means. I know that it's been --
6 it's been up on this screen several times, but it's a
7 compelling graphic, because that black line is the
8 actual interest rate, and all those other lines are
9 the forecasted interest rates by the banks. And you
10 can see how that would result in a big problem for
11 Manitoba Public Insurance.
12 And so -- and I'm going to suggest you
13 that in an analysis of this particular graphic,
14 beginning about February 2 -- 2017, you will see that
15 the banks are starting to recognize the problem, and
16 that their forecasts are kind of leveling out, where
17 before, from February 2008 to about February 2016, the
18 forecasts are showing a gradual increase. And now
19 they're showing that increase, but then a flattening.
20 It's more in line with where interest rates have been
21 for the past couple years.
22 And so this -- this particular graphic
23 is one that the Corporation points to again and again
24 to -- to -- as a -- as a -- an argument in favour of
25 going with what you know. And that is picking the

1 interest rate on a certain date and forecasting
2 everything using that particular rate. Next slide.
3 It's another graphic; not as
4 compelling, but it's in there nonetheless. And I'll
5 explain what it does. So on the very left is the
6 standard interest rate forecasting methodology, and in
7 the middle is the 50/50, and on the right-hand side is
8 the naive, the -- the methodology being proposed by
9 Manitoba Public Insurance and then you'll see on the
10 left-hand side, where it reads "differential from
11 actual," well, the zero is where you want to be. Zero
12 means you're right on a point. It's as accurate as
13 one can get.
14 And so when you look at the history of
15 how the SIRF has performed, it's not anywhere near
16 that zero line. And inside that box is the black line
17 that you should look at. So inside the box for SIRF,
18 there's a black line that runs horizontal. That's the
19 line that measures how close we should be to zero for
20 forecasting accuracy.
21 And you'll see that the SIRF is above a
22 half a percent, and that the 50/50 is just below half
23 a percent, and the naive is as nearest to that zero
24 line when compared to the other two (2). And so
25 that's the best I can explain that graphic, but that's

1 -- that, we say, is -- there's another representation
2 for support of going with the naive interest rate
3 forecast methodology.
4 So just to be clear, the naive interest
5 rate forecast takes the current actual interest rate
6 and assumes no change. So it's also called the no-
7 change model. And the forecast period is short versus
8 long term. The short term naive is the least biased
9 and more accurate, and the long term not relevant to
10 rate making or the Dynamic Capital Adequacy Test. So
11 we're only concerned with the short-term forecast
12 period.
13 So we've quoted there from our
14 Chairperson. At the end of the evidence that was
15 presented by Dr. Simpson, the Chair asked:
16 "Okay. What is the upside or
17 downside if, instead of going --
18 we're going to go naive, or 50/50,
19 or SIRF, that we just pick an
20 interest rate at a specific point
21 now, and say, that's the rate we're
22 going with, and that's what we're
23 going to put into our projections,
24 and we'll be back here a year from
25 now, and we'll see whether we need

1 to raise rates, or lower rates, to
2 take into account that rate that we
3 selected."
4 And -- and Dr. Simpson, he responded:
5 "Well, that's the naive forecast.
6 That's exactly what MPIC is
7 proposing, and has proposed."
8 MPIC forecasts to September 1, 2019.
9 Shortening the forecast period obviously improves
10 accuracy and limits the risk. So as we've seen, the
11 rate indication has gone down since the Corporation
12 filed its Application in June. And that was a result
13 of updating the Government of Canada ten-year bond
14 yield, as at September 30th, 2018. So that's more
15 accurate, obviously, than -- than what was in the
16 application in June.
17 So we have some options that are
18 available to the Board. We could stay with the
19 February 28th, 2018 rate, when the application was
20 prepared, and we see the results of that, that it
21 would be a .1 percent rate indication with a 2.1
22 percent Capital Maintenance Provision, or we could use
23 the updated numbers, which I think the Corporation is
24 inclined to do by using the September 30th, 2018,
25 Government of Canada ten-year bond yield.

1 And you've heard Mr. Johnston say again
2 and again that he wants to get it right. He is happy
3 to come here and present a lower rate indication if it
4 means his numbers are more accurate, and so he's happy
5 to have his people provide to the Board six hundred
6 and thirty-one (631) pages of modelling last week, so
7 that the Board has before it the most accurate numbers
8 available.
9 Now there's a third option there, and
10 at the risk of annoying the Chairperson, we could use
11 another rate that's closest to the rating period in
12 the form of a compliance filing. And I understand --
13 the Corporation understands the concerns -- the
14 procedural concerns the Board has with this, but by
15 virtue of a fall hearing -- we're here in October --
16 the rate year starts March 1. Just by virtue of the
17 calendar, this the best we can do. The next slide,
18 please.
19 The Government of Canada ten-year bond
20 yield. As I've said, MPI uses this forecast for the
21 new money yield. It is not the Bank of Canada's
22 overnight rate. The Corporation, and Mr. Bunston, and
23 others that know of these matters would say there's no
24 meaningful link between the Government of Canada ten-
25 year bond yield and the Bank of Canada overnight rate

1 in the short term, and that's the outlook period that
2 we're concerned with, twelve (12) to eighteen (18)
3 months.
4 Sometimes the Bank of Canada overnight
5 rate goes up, and the Government of Canada ten-year
6 bond yields goes down in the short-term. And now
7 here's a good example of that. So the Bank of Canada,
8 just last week, increased its overnight rate, and the
9 Government of Canada ten-year bond yield is presently
10 down .2 basis points lower than the forecast. And
11 when I say "the forecast," it's -- it's down from the
12 February date that we used when preparing the
13 application.
14 And a good -- just one (1) back,
15 Kristen, just -- a good example of that you may recall
16 from earlier this week was when we had the Pre-ask
17 numbers before the Board, and the Intervenors were
18 asking Mr. Johnston questions about it. Mr. Oakes
19 asked Mr. Johnston, Well, the interest rates just went
20 up last week. How does that affect my motorcycle
21 people?
22 Well, those rates are going up. That
23 was his response. And the -- the reason that the
24 motorcycle rates would -- were -- were going to go up
25 even though interest rates had gone up is because the

1 Bank of Canada overnight rate -- the Bank of Canada
2 ten-year bond yield -- Government of Canada ten-year
3 bond yield, I apologize -- went down. So interest
4 rates went up last week. The ten-year bond yield went
5 down, which meant for Mr. Oakes's motorcycle people,
6 those rates were forecasted to go up.
7 As I said at the outset, MPIC has a --
8 a new investment strategy for 2018/2019 that, in the
9 Corporation's view, materially reduces risk. It's now
10 a -- gone from a co-mingled portfolio to five (5)
11 segregated portfolios. The Basic claims liability
12 reserve, the Rate Stabilization Reserve, and the
13 pension reserve are the three (3) reserves that fall
14 within the jurisdiction of this Board.
15 The risk tolerance was determined, as
16 you've heard, by the Board of Directors. It's a low
17 risk tolerance. And that was in step with the -- the
18 investment committee, and the experts that are on that
19 committee, along with the Department of Finance. We
20 say, notwithstanding the evidence that you heard from
21 Mr. Viola, that MPIC, having lost what it did in
22 recent years, is it -- is -- had an influence or had a
23 direct impact upon the -- the risk tolerance that was
24 selected by the Board of Directors.
25 And the investment decisions in the new

1 investments strategy, as we've heard, were informed by
2 the results of Mercer's ALM study, and you heard from
3 Mr. Makarchuk on that front. The result of the new
4 investment strategy is this: A 30 percent reduction
5 in the equity required for the Corporation.
6 So, the rate -- the targets have gone
7 down. And more importantly, I would suggest, there's
8 100 percent protection against interest rate risk with
9 the new fixed-income portfolio. And that's only --
10 that's only available, according to Mr. Bunston and
11 others, with the removal of some of those growth
12 assets. So by having a hundred percent fixed income,
13 we have protection against interest rate risk. And --
14 and Ms. Sherry and Dr. Simpson both confirmed this for
15 the Chair, as I recall.
16 There is a big issue here, at least
17 from the Intervenor perspective, of MPIC not selecting
18 to include in its new portfolio real return bonds.
19 MPIC does not view inflation volatility as a real
20 risk, and the ALM study modelling does not support the
21 selection of real return bonds based on MPIC's
22 objectives and its risk profile.
23 As -- just before moving onto that, Ms.
24 Schubert, I went through yesterday a number of
25 investment decisions that MPIC would have had to make

1 in -- in arriving at its new investment strategy.
2 There were a number of investment decisions, you know,
3 the biggest of which, Mr. Makarchuk would say, was
4 moving from a co-mingled to the buckets. That's a big
5 investment decision. Lengthening the -- the
6 portfolio, another one. I won't go through them all,
7 but there were a numb -- we -- we've reduced our --
8 our holdings in real estate. We're not having any
9 equity in -- in the Basic portfolio. We're
10 diversifying in -- in the RSR.
11 There's a whole host of investment
12 decisions, as you might expect, that went into the new
13 investment strategy, and the only decision, as far as
14 I can tell, that the Intervenors took aim at, was the
15 failure to include real return bonds; that is the only
16 decision, as far as I can tell.
17 So you heard evidence yesterday that,
18 you know, well, perhaps we should have modelled the
19 liabilities on the real liability benchmark. We went
20 with the nominal liability benchmark. That, too, I
21 would suggest, is an investment decision, one that's
22 within the bailiwick of the Board of Directors.
23 Mr. Viola would say, Well, that's not
24 even really a -- that's not even really an investment
25 decision, that's just a frameworking thing. Okay. So

1 the only investment decision, then, is what asset
2 classes should be in the portfolio. And he would say
3 yes, you need real return bonds, and we said, No, we
4 don't.
5 And it's not as though it wasn't
6 considered by MPIC. That was modelled by Mercer and
7 rejected by the Corporation. And that was based
8 primarily on inflation projections. The evidence was
9 simply not there to justify the inclusion of real
10 return bonds at the risk of lower yields, lower
11 returns. And that evidence, I think, was clear that
12 if we were to replace some of the provincial bonds and
13 some of the corporate bonds with the federal bonds, we
14 would have even lower returns than we're now getting
15 under the new investment strategy.
16 And so the goal of the -- of the
17 investment strategy, according to Mr. Bunston, was not
18 -- it was not seeking returns. It was to avoid risk.
19 And so the risk to the Corporation is significantly
20 lowered as a result.
21
22 (BRIEF PAUSE)
23
24 MR. STEVE SCARFONE: So I don't want
25 to go too long on -- on the -- on the failure and I

1 don't even know if it's a failure of the -- MPIC's
2 decision not to include some investments that would
3 protect against rising inflation. But as you've
4 heard, it was based on a couple things, one of which
5 was looking at the historical data.
6 And you heard Mr. Johnston and Mr.
7 Bunston say that this is from his DCAT report, that
8 from 1992 to 2017, the mean inflation rate was 1.80
9 percent. And I know Mr. Viola will say, well, you
10 know, you have to pay attention to that standard
11 deviation. But -- and I'm not a statistician guy, but
12 the mean, in my view, is what's important, because
13 that's what the actual inflation rate was, 1.8 percent
14 from 1992 to 2017. That was the mean.
15 And you heard Mr. Viola admit yesterday
16 under cross-examination that MPIC is in fact covered,
17 that was -- those were my words, but there is
18 protection against inflation up to 2 percent. The
19 concern he has is if inflation rises above that 2
20 percent and the volatility that inflation has. And
21 the volatility is -- would just mean inflation going
22 up and down.
23 And it's important to note here that if
24 inflation was a real and genuine concern, then the
25 Dynamic Capital Adequacy Test should reflect that.

1 And what I mean by that is, Mr. Johnston will tell you
2 that when he's running the DCAT he puts in these
3 adverse -- adverse scenarios and he has a top three
4 (3), which is, you know, we've heard that a decline in
5 -- in equities is one (1), that can result in
6 significant losses. Another one is a really bad
7 winter where there's a whole -- a whole host of car
8 accidents and insurance claims.
9 These are scenarios that Mr. Johnston
10 runs in his DCAT, as what he calls adverse scenarios.
11 High inflation isn't one (1) of them. And the reason
12 it isn't one (1) of them is because it was written off
13 as not being a plausible adverse scenario. And that
14 was done in collaboration with the Public Utilities
15 Board and the Intervenors. They decided that -- that
16 it wasn't a significant concern, not enough at least
17 to -- to attract the attention of the DCAT.
18 And so accordingly, I would suggest as
19 a result, investment decisions were made on the basis
20 that inflation outlook would be low and stable. So it
21 -- it shouldn't come as a surprise to the Board that
22 the investment strategy doesn't protect the
23 Corporation, Mr. Viola's view, against rising
24 inflation, especially in the long term, when we have
25 collaborative -- collaboratively agreed that it's not

1 a concern. And -- and it -- and we don't even have to
2 run it through the DCAT.
3 So in the result, MPIC, I would say
4 that its assumptions, particularly on inflation and
5 the investment decisions that have been made are
6 reasonable.
7 And this just touches upon the -- the
8 evidence that we've heard from the two (2) experts,
9 both Mr. Viola and Mr. Makarchuk indicated that, as
10 anyone in the room will appreciate, the factors to be
11 considered when making investment decisions are risk
12 and reward and cost and time.
13 And in Mr. Makarchuk's view the
14 expected returns would have been materially lower had
15 the real return bonds been included in the portfolio,
16 in the Basic claims portfolio. Next slide, please.
17 So this particular slide we saw
18 yesterday and again today, and this was the result of
19 some further modeling, Mr. Chair, you'll be well aware
20 of the motion that the Consumers Association of Canada
21 brought that compelled MPIC to have the Mercer Group
22 conduct further modeling and specifically with respect
23 to real return bonds.
24 So, Mercer was asked by Mr. Viola,
25 through the Intervenor, to model the -- an investment

1 strategy that included a real return bonds and other
2 asset classes. And you heard Mr. Viola say, as a
3 result, you can see that on the modeling that we --
4 that was done by Mercer, when you remove the real
5 return bonds, you're losing 80 basis points in
6 returns.
7 But I'm going to suggest to you that
8 it's not a very useful model to the extent that we
9 know there was some cherry picking of sorts, and they
10 were building a -- a portfolio that included asset
11 class -- classes that the Corporation just wasn't
12 prepared to purchase.
13 So this particular modeling that shows
14 a decrease of .8 percent when you remove real return
15 bonds, also included private debt. The Corporation
16 wasn't interested in private debt. Included private
17 equity. The Corporation wasn't interested in private
18 equity. And growth fixed income.
19 So it -- it's not, in our view, a fair
20 representation, deliberate or not, to say that this
21 shows that real return bonds would've been of some
22 benefit to MPIC and the ratepayers, because it
23 specifically includes asset classes that Corporation
24 said no to.
25 And I would suggest to you that those

1 three (3) categories are -- are largely inconsistent
2 with the low risk tolerance that the Corporation has
3 now in place.
4 And the last slide on investments is --
5 is one (1) that just sets out the -- the issues that I
6 think that were canvassed by both Mr. Makarchuk and
7 later by Mr. Viola. So should the liabilities, that
8 is MPIC's obligations under the Basic program, have
9 been modeled with a real benchmark, of course, they
10 weren't. They were modeled with a nominal benchmark,
11 as we know.
12 And the important thing there, and you
13 heard this yesterday, that's a decision that lies with
14 the investor. That's the decision that the Board of
15 Directors is -- is entitled to make and it would be
16 under their mandate to make these investment
17 decisions.
18 They've been appointed by the
19 Government of Manitoba, and so they are responsible.
20 The Government of Manitoba has identified these
21 members of the Board of Directors, specifically the
22 Investment Committee, to do what's right and make
23 investment decisions on behalf of the ratepayers of
24 Manitoba Public Insurance. That's their job.
25 And the second question there, should

1 the recommended asset mix hedge inflation risk? Well,
2 it does to some extent. It hedges nominal inflation
3 risk, but not real.
4 And so there is some protection against
5 inflation, but only up to 2 percent. And there was no
6 evidence adduced before this Board that showed
7 inflation is expected to rise above 2 percent. That's
8 the bottom line. There's no evidence.
9 And I'll leave the remainder of the
10 closing to Mr. Guerra.
11
12 FINAL SUBMISSIONS BY MR. ANTHONY GUERRA:
13 MR. ANTHONY GUERRA: Thank you, Mr.
14 Scarfone.
15 So now we're going to be moving on to
16 ratemaking expenses and revenues. The -- the next
17 series of topics are -- are going to be discussed not
18 in as much detail, because as I agree with Mr.
19 Scarfone, the -- the focus of this year's GRA is
20 really on -- on capital. Capital touches upon these
21 issues, not nearly as much, though, as the issues that
22 were canvassed by Mr. Scarfone. Nonetheless, they are
23 important to discuss and I will -- I will do so.
24 On the issue of ratemaking, we know
25 that rates are now established in accordance with AAP.

1 There are no new changes to the way in which we plan
2 to make rates this year, but it's important to
3 remember that breakeven rates are separate from the
4 capital maintenance provision.
5 Breakeven rates mean that the revenue
6 and costs associated with the new policies are
7 properly costed. The Capital Maintenance Provision,
8 on the other hand, is to ensure that there's an amount
9 in place to maintain the capital of Basic in that
10 policy year. So in this GRA, MPI only seeks a 0.1
11 percent increase in breakeven rates.
12 Now, we've updated that to 2000 --
13 sorry, to September 28th, 2018, and that results in a
14 decrease of 0.26 percent, if those are the numbers
15 that are ultimately preferred by the -- by the Board.
16 Next slide, please.
17 This chart we say highlights the
18 success that MPI has achieved in really making
19 expenses a non-issue or non-factor in rate
20 applications. And -- and as we see from the chart, we
21 were projecting in 2017 for a steady increase in
22 expenses.
23 And up until today's date, what we're
24 seeing now is for the 2018, 2019 and 2021 years, a --
25 a reduction in expenses. And -- and the -- the

1 members of the Corporation who were involved in the --
2 the -- the different aspects of the business that --
3 that contribute to that should be commended for their
4 efforts. It really does say a lot that over such a
5 small period of time, the expenses position could --
6 could change so dramatically. Next slide.
7 We heard about MPI's new position on
8 managing longtail body -- bodily injury claims. And
9 in specific we heard about the two (2) topics of -- of
10 claims intake and triage and centralized reserving.
11 On the issue of intake and triage, we
12 now have a process to identify what we call complex
13 claims earlier on. What we do is we now -- we now
14 manage those claims in a way that improves the outcome
15 for the customer, and also improves the resolution
16 time for the Corporation which -- which has a tendency
17 to decrease expenses as well.
18 While there will be an increase -- or
19 there has been an increase in full-time employees
20 which just very recently happened, we are expecting
21 that -- that this will -- will improve the claims cost
22 approach, and we look forward to providing a further
23 update on -- on that process in the next GRA.
24 With respect to centralized reserving,
25 we now have a centralized reserving unit and -- and we

1 submit that that solves the problem that we incurred
2 in previous GRAs with respect to, perhaps, optimistic
3 reserving practices. So again, we would expect that
4 in the next GRA, we would be able to provide an update
5 suggesting that the centralized reserving practice has
6 also been beneficial.
7 Information technology was a -- a focus
8 of this year's Application. I would submit more so in
9 the -- in the phases that -- that preceded the -- the
10 hearing. And I think that's a -- a testament to the -
11 - the job that MPI did in becoming very transparent
12 about its IT projects and how it costed them, or
13 perhaps did not cost them in the way it should have
14 and -- and how it's -- how it structured its practices
15 moving forward to address some of the past issues that
16 it -- it experienced.
17 So I'd like to approach the topic of
18 information technology in the past, present and
19 future. Past meaning the two (2) projects that MPI
20 considers to be -- to have lacked the -- the -- the
21 business perhaps value that it expected. So we have
22 the customer claims reporting system and the property
23 damage re-engineering project.
24 The present, where we are right now,
25 which is the development and information -- excuse me,

1 implementation of a new IT strategy, our development
2 and implementation of a new value management strategy,
3 Gartner's assessment on where MPI's stacks up against
4 its peers on issues relating to information
5 technology, and the ongoing implementation of MPI's
6 staffing strategy.
7 In the future we've heard some evidence
8 about where MPI is hoping to take its legacy
9 modernization project.
10 Focusing at this moment on the past,
11 the customer claims reporting system. This was really
12 MPI's failed attempt to be an innovator. It was
13 cancelled in April of 2018 after it was reviewed using
14 the value management process.
15 But as we've heard, MPI retains the
16 intellectual prop -- property from that project, and
17 it may rely upon that in the future to its benefit.
18 And I -- I say that only because although MPI
19 considers this to be a failed project, even failed
20 projects do have some silver linings and some benefits
21 that may be realized in the future.
22 The same may be said about the property
23 damage re-engineering project. This failed because
24 MPI failed to adequately cost the project, and was too
25 focused on the benefits. But the program has

1 standardized and improved the estimating process and
2 has opened up future possibilities for MPI.
3 The present, where are we now? We have
4 a new IT strategy which ensures that the business
5 needs of the Corporation are met by IT and business
6 capabilities. It's a shift and an approach -- or it's
7 a shift in the approach of MPI to IT. And we say it
8 now aligns better with industry best practice. As you
9 heard from Mr. Bunko, it's a difference now between
10 where we were and where we're heading.
11 And I would like to turn over to the
12 next slide, please, as this box, perhaps not as -- as
13 clear as I would've liked to have had it, but
14 regardless, it's important I think to restate where we
15 were verses where we were headed -- or where we are
16 headed, rather.
17 We were leaders in creating innovation,
18 we're no longer that. We are now about adopting
19 proven mainstream technology. We used to execute
20 high-risk projects. We now identify all the risks
21 prior to initiation and incorporate that into the
22 project decision.
23 We used to have project governance with
24 nonbusiness project sponsors for all projects. We now
25 have the operational business champion, who testified

1 before the Board this year, Ms. Campbell.
2 We customized -- we used to customize
3 out-of-the-box software to suit our processes. Now we
4 will align wherever possible with -- our processes
5 with the industry best practice and incorporate vendor
6 software as provided.
7 We used to candidate projects that were
8 not vetted through the detailed van -- value
9 management process. This year we heard lots about the
10 new value management process and how it has become
11 ingrained in the MPI process, and in fact, its
12 culture.
13 And we used to have technology drive
14 change within the organization. Now, it's the other
15 way around. IT capabilities are created to support
16 the business capabilities.
17 Going back to the topic of value
18 management. The process now ensures that projects are
19 -- are properly informed and costed. It was applied,
20 as we mentioned, to both the CCRS and PDR projects,
21 and the results show its potential for success in
22 measuring the adequacy and the costs and benefits of
23 those projects.
24 It required a culture -- sorry, a
25 change in MPI's culture, but as I mentioned, it is now

1 something that we consider to be ingrained in that
2 culture.
3 We're now still implementing the staff
4 strategy. You've heard evidence that twenty (20) of
5 the twenty-seven (27) external IT consultants were
6 successfully transitioned to full-time employee
7 status, and you also heard that MPI continues to make
8 progress towards its goal of -- or transitioning the
9 remaining twenty-seven (27) consultants with an
10 updated savings of approximately $3 million, I believe
11 is what the -- the total was now.
12 And finally, we heard evidence from Mr.
13 Henry about where MPI stacks up against its peers with
14 Gartner's assessment or IT score. So if I could ask
15 you to change the slide, Ms. Schubert.
16 And -- and what this really looks at is
17 the new IT score, which measures MPI against the
18 industry average. Oh, that's much better. Thank you.
19 And as we can see here, in almost every
20 case either MPI aligns completely or exceeds the --
21 the -- the other established peers and -- and there --
22 although there are always room for -- there's always
23 room for improvement and MPI will continue to focus on
24 improving and -- and satisfying the recommendations
25 made, it should be noted that there have been

1 improvements, including with respect to improving its
2 maturity and reducing its costs.
3 And I think Mr. Bunko testified that
4 it's very difficult for -- for one to improve maturity
5 at the expense of -- of reducing costs and so that
6 should also be noted as well.
7 The future, where are we going? Well,
8 we heard again a bit of testimony about the legacy
9 modernization project. It's still an ongoing project
10 in its infancy. MPI so determined the approach to
11 take, but has assured and will continue to ensure all
12 the stakeholders that it will apply the new value
13 management process to that project, and will be open
14 and transparent about where its direction is headed.
15 Vehicles for hire. Vehicles for hire
16 was not a -- a significant issue in this application,
17 but it does form part of the rate ask. And so it
18 needs to be addressed.
19 So MPI has applied for final approval
20 of the 2017, 2018 and 2018/2019 vehicle for hire --
21 excuse me, it should be vehicle for hire rates for
22 service, and also applies for the rates for 2019, 2020
23 using the same methodology.
24 What you heard in terms of testimony on
25 the issue of vehicles for hire was that it's time band

1 model or the time band model complies with the
2 existing regulatory process and appears to be working.
3 MPI continues to amass data that it will continue to
4 analyze to determine whether or not future rates
5 should be modified.
6 The DSR incentives and loss prevention
7 strategies should help close the gap between the
8 taxicab vehicle-for-hire category and the passenger
9 vehicle-for-hire categories as well. MPI will
10 continue to look at those two (2) to determine whether
11 or not there should be additional measures taken in
12 regards to those rates.
13 And finally, ongoing topics. These are
14 items that were -- will -- will be forming probably a
15 bigger portion of GRAs in future years. Obviously,
16 there were some questions asked about the -- the
17 position of MPI on its driver safety rating. We know
18 that last year the Board approved a 1.8 percent
19 increase in driver premiums through the demerit side
20 of the DR -- excuse me, the DSR scale and that we held
21 a technical conference on the issue on March 20th,
22 2018.
23 The issue was whether -- sorry, the
24 issue is not whether a DSR premium should be
25 actuarially sound. I think MPI would agree with the

1 Board that that's a nonissue. What really appears to
2 be the issue is what is the appropriate model or
3 alternative model to be used, and the evidence is that
4 MPI is consulting with the public on the issue and
5 plans to provide an update of the results of its
6 analysis in the upcoming rate application for 2020.
7 Service fees. We heard that MPI is not
8 asking for a change in its service fees in this
9 General Rate Application, and nor is it seeking to
10 introduce any new service fees this year as well.
11 As we know, a service fee review was conducted in the
12 2017/2018 fiscal year and the results were shared with
13 the Board in this year's GRA.
14 We are waiting, however, a decision
15 from the Government of Manitoba on the service fees
16 under the Driver and Vehicles Act, and at this point
17 in time Manitoba Public Insurance is not prepared to -
18 - to seek a change in the non-DVA service fees until
19 the results of that decision are -- are made known.
20 We expect that we'll be able to provide an update on
21 this issue as well in the upcoming GRA.
22 So to -- to close off again, the issue
23 here is whether or not MPI's application is --
24 presents rates that are just and reasonable. That's
25 the test.

1 MPI submits that its conducted
2 countless hours trying to balance, coming to a balance
3 between the -- the interests of maintaining the -- the
4 financial adequacy of the Corporation, versus making
5 sure that the -- the rates charged to consumers are no
6 more than what is absolutely necessary.
7 We feel that we've -- we've struck that
8 right balance. There is a decision to be made,
9 though, by the -- by the Board as to how we structure
10 this. Do we use the rates, the interest rates as --
11 as at February 28th, 2018, as at September 28th, 2018,
12 or at some date in the future through a compliance
13 filing?
14 MPI is prepared to -- to cede some
15 discre -- discretion to the Board as to what is the
16 appropriate approach. It should be based, though, on
17 the naive interest rate as that is, at least in the
18 short term, we're talking about twelve (12) to
19 eighteen (18) months, that is the most accurate way of
20 predicting those interest rates.
21 2018/2019 vehicle-for-hire rates should
22 be approved based on the current methodology, and
23 final approval should be given to 2017/2018 and
24 2018/2019 vehicle-for-hire rates as well.
25 Subject to any questions, those are our

1 submissions. Thank you.
2 THE CHAIRPERSON: Thank you to both of
3 you. I'll ask the panel if they have any questions.
4 Any questions...?
5 Okay, Mr. Scarfone, I've just got a
6 question. Can we go to, Kristen, page 20 -- I can't
7 read my notes, 28.
8 Mr. Scarfone, can you confirm with me
9 that 50/50 was proposed by MPI two (2) years ago?
10 MR. STEVE SCARFONE: Yes. It was a
11 proposition put forward by MPI. That was when Dr.
12 Cleary gave some evidence from MPIC.
13 THE CHAIRPERSON: Correct.
14 MR. STEVE SCARFONE: Yes.
15 THE CHAIRPERSON: And at the time,
16 interest rates had been flat for -- for a considerable
17 period of time?
18 MR. STEVE SCARFONE: For almost five
19 (5) years.
20 THE CHAIRPERSON: Okay, I just want to
21 confirm that.
22 That's the only question. Gentlemen, I
23 appreciate the submission, especially given that it
24 occurred so quickly after Mr. Viola finished his
25 testimony.

1 Mr. Oakes, we have a time constraint,
2 I'm just wondering how long your submission would be.
3 MR. RAYMOND OAKES: Mr. Chairman, I
4 plan on being very direct and to the point and
5 concluding in less than ten (10) minutes.
6 THE CHAIRPERSON: Oh well, we love to
7 hear that, Mr. Oakes, thank you. If you'd like to
8 proceed with your submission now. Thank you.
9 MR. RAYMOND OAKES: Thank you, Mr.
10 Chairman.
11
12 FINAL SUBMISSIONS BY MR. RAYMOND OAKES:
13 MR. RAYMOND OAKES: MPI comes to this
14 public utility rate hearing this year after a year of
15 superlative financial performance and condition. To
16 put it very simply, income is up and both claims costs
17 and administrative costs are down.
18 Retained earnings for the Corporation
19 grew from 261 million in 2017 to 352 million by
20 February 28th, 2018, and then 425 million as of August
21 31st, 2018.
22 Operating expenses decreased $5 million
23 for Basic and overall claims costs decreased by $72.5
24 million.
25 Investment income -- income increased

1 38.2 million, and the 2016/'17 net investment yield
2 increased to two -- 6.08 percent. The superlative
3 results are indicated in my cross-examination from
4 pages 567 through 571, and also demonstrated a very
5 significant trend in the loss ratios where they
6 declined in the period from 2007 to 2015, that nine
7 (9) out of eleven (11) years, as confirmed by Mr.
8 Johnston at page 571 of the transcript at lines 19 to
9 25 and following.
10 We saw the Corporation apply for rates
11 for motorcyclists. The actuarially indicated rate was
12 between .9 and 1 percent, that was indicated by Mr.
13 Johnston at page 562 of the transcript, lines 20 and
14 21.
15 The best evidence of the Corporation
16 could bring, the most recent, was September 28th and
17 that dropped the required actuarially indicated rate
18 down to some .2 percent for motorcycles, which we
19 would suggest should be rounded down to zero.
20 This is, of course, based on the naive
21 interest rate forecast and we'll speak more about that
22 in a few minutes.
23 MPI then, based on that September 28th
24 financial information, was seeking a 2.2 percent
25 overall rate increase for motorcyclists due to their

1 very creative creation of a new cash cow that they
2 call the Capital Maintenance Provision, or CMP. This
3 additional percentage increase attributable to this
4 new grab is not part of the accepted actuarial
5 practice rate calculation, and that's admitted by Mr.
6 Johnston at page 563, lines 10 to 13.
7 Mr. Johnston finally concedes at page
8 564 of the transcript, lines 15 to 24, that the
9 Corporation can use what I had termed its arbitrary
10 management decision to re -- arrive at whatever number
11 they feel is justified for this new CMP.
12 As we know, this new provision is
13 politically motivated. The president of the
14 Corporation confirmed that his Board of Directors and
15 the government of the day have directed that the
16 Corporation should collect as much money as possible
17 in order to provide smooth sailing for the government
18 and the Corporation, irrespective of their mandate to
19 provide breakeven equitable affordable auto insurance
20 in this province.
21 And of course, those are my words, but
22 that's what I see and understand the position to be.
23 The advantage to the Corporation in
24 collecting 18 million to 20 million, that is not
25 actuarially determined to be necessary at this point,

1 is obvious. In the case of missteps made by this
2 Corporation's executive, such as the race -- recent
3 PDR and other IT initiatives, results in unanticipated
4 waste of money and the Corporation doesn't have to
5 come back to this Board to justify receiving funds for
6 that folly.
7 Mr. Scarfone said today that there was
8 no more risky IT initiatives, unless they are
9 necessary for core business functions. And that gives
10 me quite a bit of concern as certainly the history of
11 those projects would indicate.
12 So the -- the CMMG is an example, I
13 would say, of the talent that they have and especially
14 their creative genius. It's a -- calls to mind when I
15 think of how this might work to -- to MPI and the
16 executive, how they came up with this. I think of the
17 Cow Brand Baking Soda company. There, that company
18 makes and sells a baking ingredient, but they're not
19 content with that and they invite -- invent new uses
20 and -- for sales.
21 Imagine if you will these talented
22 geniuses are sitting in a boardroom, and one (1)
23 executive says, tell you what, here's an idea, we'll
24 tell the people to open it, put the baking soda in the
25 fridge and then throw it out after two (2) or three

1 (3) weeks. The other executive turns to him and says,
2 I've got a better one. I'm going to get the consumers
3 to buy it, pour it immediately into the garbage to
4 make it smell better. So that type of creativity
5 certainly has some rewards, and this Corporation
6 certainly has some talented geniuses on their side.
7 Two (2) years ago they came up with a
8 IRFR. This surcharge would generate about $20
9 million. Create a slush fund in addition to the other
10 revenues, if things don't go the way the Corporation
11 forecasts.
12 This year it will be the CMP, again,
13 about $20 million. Mr. Johnston says at page 1382,
14 it's a coincidence, but I believe the motivation comes
15 from the same creativity, surcharge using a newly
16 created acronym that the Corporation tries to convince
17 everyone in the room was necessary. Just like putting
18 baking soda into your fridge or the garbage, but it
19 turns into this $20 million cushion for the
20 Corporation.
21 I'd suggest that if the Corporation
22 uses its best estimates, then there's no need for
23 these slush funds or cushions in the event of negative
24 performance.
25 The CMMG would submit that the CMP is

1 not actuarially sound, it's not justified on the basis
2 of the recent financial performance, that it would
3 result in fair and inequitable rates, and it would
4 provide no incentive for the Corporation to continue
5 to tighten its -- its belt and be thrifty with his
6 expenditures.
7 We would submit that -- respectfully
8 that the Public Utility Board should continue to hold
9 the Corporation's feet to the fire, so to speak, to
10 ensure it does a diligent job of matching assets and
11 liabilities, making good investment selections and
12 managing its claims and administration prudently.
13 This type of performance will result in
14 additions to the RSR from the bottom line of the
15 Corporation, and not require the Corporation to
16 creatively develop new ways of skimming money off the
17 premiums to be paid by its Manitoba insured.
18 This all, as well, leads us to the RSR,
19 and at pages 592 of the transcript and following we
20 reviewed the PUB approved ranges of the RSR from 2005
21 to present. Although the Corporation was able to
22 carry out its mandate as conceded by MPI in years
23 where the RSR approved range was as low as $50
24 million, the Corporation was somehow able, in 2015/'16
25 to convince this Board that the appropriate range was

1 231 million to 366 million.
2 Even Mr. Johnston of MPI acknowledges
3 that the corporate risk profile was only 4 or 5
4 percent higher than in years previous, and the
5 reference is page 595 of the transcript, lines 9 to
6 11.
7 But somehow that RSR target range is
8 still doubled from the previous year. Mr. Johnston
9 also conceded at page 593 that the provision of
10 insurance was likely unchanged from the previous year.
11 But again, these targets still reach fantastic levels
12 without any need in the view of the CMMG.
13 At page 596 of the transcript, Mr.
14 Johnston agrees that during the 15 years of the RSR
15 approved range, which we reviewed, there were not
16 significant drawdowns on the RSR as a result of
17 insurance issues.
18 The Corporation has forecasted that at
19 the end of the year 2019/20 the RSR is going to be
20 some $280 million. It is currently sitting somewhere
21 in excess of 200 million. I would submit that the RSR
22 is already far larger than what is needed, given the
23 history of the Corporation in providing its mandate to
24 Manitobans, and this supports our contention there is
25 no need for CMP at this time.

1 The Corporation's creativity also plays
2 out in the number of claims reserves and other
3 reserves that it maintains, it -- for example it
4 maintains 234 million in claims reserves as
5 subrogation reserves of some $30 million, doubtful
6 accounts another million dollars. And then there's
7 the provisions for adverse deviations to cover what I
8 would think are every possible eventuality.
9 In looking at all of these reserves and
10 Pfads, one (1) similarity is evident, despite the fact
11 that deviations and results can be either positive or
12 negative, the Corporation deals with all of these by
13 collecting more money and developing all of these
14 pools of funds to feather the nest going forward.
15 The Corporation's approach when it
16 comes to the interest rate methodology, again, is
17 directed at selecting the approach which would most
18 likely produce a large financial cushion for the
19 Corporation at the expense of fair and equitable rates
20 for its Manitoba insured.
21 Mr. Makarchuk at page 604 of the
22 transcript indicates that short interest rates have
23 definitely gone up. His evidence at page 15 of his
24 report, Exhibit 23, says that:
25 "While we acknowledge the Canadian

1 inflation rates have increased
2 significantly since the time of the
3 study, 2.8 percent at August 2018
4 versus 1.4 percent at August 2017
5 [and confirms at page 603] that
6 there is correlation between where
7 the short-term inflation is and the
8 short-term interest rates."
9 The interest rate methodology is an
10 extremely important issue for motorcyclists. Mr.
11 Johnston at page 1369 of the transcript, lines 21 to
12 23, says that it looks like motorcyclists are about
13 twice as sensitive. Perhaps -- maybe a little more
14 than passenger vehicles.
15 Under the 50/50 methodology, the
16 breakeven rate indication is a .6 reduction in
17 motorcycle premiums. Even if the Board endorses the
18 CMP, then it would only be a 1 percent increase.
19 The Corporation confirms at page 1368
20 of the transcript that if interest rates rise in 2019,
21 then, all things being equal, we would have changed
22 more than we would have if we had used the lower rate,
23 which I submit is not equitable, the Corporation would
24 collect those additional premiums. It isn't fair. It
25 isn't in keeping with breakeven rates.

1 As per CMMG Interrogatory 1-4, we've
2 already had three (3) years since 2010 were the loss
3 ratio was under 56 percent.
4 When we look to what's happening in the
5 marketplace and the economy, we've already seen the
6 increases in the Government of Canada ten-year bond
7 rates, and more recently in the Bank of Canada
8 interest rates.
9 At page 586 of the transcript, Mr.
10 Bunston says:
11 "While I think both central rates
12 have indicated they expect their
13 administered overnight rates to
14 increase gradually."
15 As previously indicated, considering
16 all of that, I respectfully submit that it would be
17 naive for this Board to accept a naive interest rate
18 formula at this time.
19 I do understand and recognize how
20 various of the parties have gone back and forth over
21 the past few years in either selecting the naive or
22 the 50/50 interest rate methodology, but I think to
23 not acknowledge the recent environment of increases in
24 interest rates at this time is kinda like the Board
25 being on guard duty for the night. And sometime

1 before dawn, they walk away and say this is silly to
2 be on guard anymore, and nothing's happened in the
3 past few hours.
4 In all, the CMMG is calling on this
5 Board to ensure that the excellent financial climate
6 that the Corporation has enjoined during the past year
7 is reflected in rates that are fair and equitable and
8 actuarially sound. This necessity excludes a
9 collection from CMP.
10 CMMG is not in favour of a rebate, but
11 that even would be more appropriate than the
12 Corporation's attempts to gird the piggy bank a little
13 more.
14 Before the Board should look at -- I
15 suggest that the Board should look at the Application
16 directionally, look at the recent financial
17 experience, look at the recent interest rates on the
18 move. The rates should be flat without the insurance
19 consumers of Manitoba paying more than they should
20 have to. A discount based on the 50/50 interest rate
21 methodology is indicated and is justified given the
22 Corporation's financial performance.
23 I'd like to, at this time, thank the
24 Corporation and its witnesses for their skill and
25 presentation of the Application. They did so with

1 candor and with great knowledge.
2 I join the Board in wishing Mr. Ward
3 Keith his -- best wishes on his retirement. The CMMG
4 was very pleased to work with him for several years
5 and was always impressed by his competence and skill.
6 And lastly to the Board, I thank you
7 for the consideration of our intervention.
8 THE CHAIRPERSON: Thank you very much,
9 Mr. Oakes.
10 This concludes today's session. We
11 will adjourn until 9:00 a.m. tomorrow morning, when we
12 will hear from counsel for the Consumers Association
13 of Canada and a reply, if any, of MPI.
14 Thank you very much.
15
16 --- Upon adjourning at 3:10 p.m.
17
18 Certified Correct,
19
20
21 _____________________
22 Cheryl Lavigne, Ms.
23
24
25