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

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APPEARANCES

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Steven Scarfone	)Manitoba Public
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--- Upon commencing at 9:05 a.m.

THE CHAIRPERSON: Good morning, everyone. Ms. McCandless...?

MS. KATHLEEN MCCANDLESS: Good morning, Mr. Chair, members of the panel.

Today we are going to hear from CAC for their closing submissions and then we will have any reply from MPI and that will conclude our proceedings.

THE CHAIRPERSON: Thank you. Mr. Williams...?

FINAL SUBMISSIONS BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Thank you and good morning -- morning, members of the panel. Just a couple of introductions, our client Ms. DeSorcy, who's been a regular fan of these proceedings is -- is behind us and out in the -- the huge audience to -- to my right is our colleague Ms. Amanda Beaumont who is -- - is responsible largely for the presentation, the PowerPoint that's -- that's before.

THE CHAIRPERSON: Could you point her out, Mr...

I just like the -- all of the people on line to understand the depth of that.

DR. BYRON WILLIAMS: Yeah, it -- it is hard to pick her out.

I also just on -- just by preliminary comments, our clients do want to thank the Public Utilities Board for this opportunity. The Intervenor support program is -- is very important to the dialogue and our client truly appreciates the -- the opportunity that they have.

Just as we go through the documents, I'll indicate we've got a lot of the references from the record, from the transcript. If they're in italicized font, those are direct quotes. If they're not in italicized fonts those are paraphrases and certainly we've put the page reference there so if you don't trust my paraphrases, you can always go back to the record.

And finally, there are two (2) confidential slides that -- that we -- we may get to a bit later. I believe our PowerPoint would be CAC Exhibit 30 and I'm getting the nod from the Board secretary.

--- EXHIBIT NO. CAC-30: CAC PowerPoint Presentation.

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: So the title is Cushion, Comfort and Accountability, Regulatory Independence and Captive Ratepayers.

And our clients certainly in this hearing is going to focus on the -- the importance of the independent regulatory process as signalling to Manitoba Public Insurance what are efficient choices that -- that best protect both itself and consumers.

And I want to start with just a discussion on irony. And our client certainly considers this to be an ironic application. Irony Element 1, we have a corporation seeking a roughly $20 million rate cushion, the Capital Maintenance Provision. During the same General Rate Application is announcing roughly a $20 million write-off of imprudent information technology expenditures.

Ironically, we have a corporation that claims a commitment to fiscal prudence but calculating that $20 million Capital Maintenance Provision via a minimum capital target that expressly provides an eight (8) figure cushion for, in quotation marks, "inadequate or failed internal processes."

And ironic this application because we have a Crown monopoly entering a new age of accountability and transparency. But then think back to the IT -- the information technology pane, the it wasn't me information technology panel, where corporate culture was blamed for the -- the decisions -- the imprudent decisions that were made.

The irony does not escape our clients in this hearing. That we have external experts presented by MPI who consumers trust to be independent, but these external experts, in the case of Gartner, for -- did not apply basic elements of a fulsome, in quotation marks, "net present value calculation."

And we also have an expert, Mercer, who allowed their best estimates of future interest rates to be sub -- suborned by their clients' choices, materially suborned.

From our clients' perspective, there is an irony in this hearing where we have a Crown monopoly professing a low risk tolerance for investment risk, yet, assuming away long term inflation and real interest rate risk in the portfolio, generally, and bond specifically and not testing the consequences of its decision, whether by its failure to test for a material tracking error -- basis risk is another phrase for that -- or choosing not to undertake the stress tests recommended by Mercers. And you'll see that in Exhibit 44, filed by Manitoba Public Insurance late in the hearing, and which has kind of gone under the radar.

Finally, our client finds it ironic when in an era where mandate letters are talking about operational independence and freedom from political interference to have, in this hearing, overt hints to the Public Utilities Board of the will of the government.

Our clients are captive ratepayers. They are highly vulnerable; not only with the legal, the statutory monopoly on Basic but with the factual market dominance of Manitoba Public Insurance in Extension. And there are two (2) key consequences of that monopoly. One (1) is, our clients, that Basic consumer right of choice, has been effectively nullified and, secondly, efficiency signals for a Crown monopoly as compared to publicly traded private sector companies in a competitive marketplace are significantly muted. MPI does not face the risk of ratepayer flight, unlike the entities regulated by the Office of the Superintendent of Financial Institutions.

No efficiency signals are sent to

Manitoba Public Insurance through the price of shares in the marketplace, unlike publicly traded companies. And its sole shareholder is subject to many political pressures.

In this context, our clients rely upon this Board to ensure that monopoly power is not abused through rates that are unjust or unreasonable and to protect future ratepayers by sending efficiency signals that the marketplace cannot, by virtue of the monopoly.

Slide 8 presents the Board's statutory jurisdiction and highlights its independent nature. We all know the Board's mandate is -- is to set just and reasonable rates.

And on slide 9, our clients outline the four (4) elements of the -- the five (5) elements of that just and reasonable test as historically applied by the Board:

Ensuring that forecasts are reasonable and that, of course, is important when we look at the interest rate forecast;

Ensuring that actual and projected costs and behaviours are necessary and prudent and that is a critical element of this hearing;

Assessing the reasonable revenue needs

of the application -- of the applicant in the context of its overall health and that certainly goes to issues such as the reserves and the CMP, Capital Maintenance Provision;

Less prominent in this hearing is the allocation of costs between classes or between ratepayers;

And ultimately, setting just and reasonable rates.

Our client admits to being puzzled by what it understands to be the Manitoba Public Insurance case theory. Our client understands, at least when it relates to infor -- information technology, it is to acknowledge past errors and to plead for forgiveness.

But then, the Corporation goes on to suggest that it be insulated from accountability for future mistakes by the $20 million rate cushion and it asked for a cushion for stable rates because it tells us, as Mr. Graham did later in the hearing on October 23rd, that the provincial government has concerns about net income volatility.

And that's all very fine and good, and that's important. But when we set just and reasonable rates, rate stability is only one (1) consideration.

Prudence, reliability of forecasts, the overall health of the Corporation, fairness between ratepayers, fairness between different generations of ratepayers are critical. And certainly our client sees the Capital Maintenance Provision as inconsistent and we'll get to this after the coffee break with long-term principles of intergenerational equity.

MPI is also asking this Board to take a hands-off approach to its investment portfolio because its Board claims to have low risk tolerance.

And our client acknowledges that Crown corporations are entitled to make imprudent mistakes. They are entitled to rely on the BI3 technology and take a passive approach to complex claims management with long -- long-standing rate cost to consumers.

On the second bullet, they're entitled to have IT staffing -- the word should be inserted "budget levels" -- far higher than the industry average. They are entitled to enter into technology adventures relating to physical damage re-engineering including the customer claims reporting service assistant.

They're entitled to do that without appropriate business cases and they're entitled to do so without disclosing material information to external third-party advisors, with the Public Utilities Board and consumers are trusting to provide intent -- independent advice.

Manitoba Public Insurance is entitled to assume away real interest rate risk in the design of its minimum risk portfolio, the nominal lia -- liability benchmark. And to do so without testing for tracking error or undertaking stress tests. They're entitled to do that.

And they are entitled to cherry pick an interest rate forecast other than the preferred estimate of its external third-party advisor.

But the Board has its own privileges, its own responsibilities, its own rights and the Board -- this Public Utilities Board is not obliged to pass on these imprudent cost to ratepayers. It is not obliged to build a cushion for imprudence into the rates or to pass on imprudent and unreasonable costs.

In the sections that follow, we're going to talk a little bit about the rate implications for individual consumers and then to seek to apply that just and reasonable analysis that the Board is set out for us in -- in prior Orders, have a little conversation towards the second last bullet on slide 13 in terms of consumer engagement and that's when you'll be relieved to hear that you no longer hear from me after that second last bullet and I'll turn it over to my colleague Ms. Dilay, and she will take you home with our clients' recommendations.

Our client does want to talk about the implications of the rate application for individuals. And my client Ms. DeSorcy always reminds me that it's about people. It's not about theory. It's about the real live impacts on ratepayers.

Manitoba Public Insurance historical and current opinion polling tells us that the value proposition for ratepayers relates to price. It tells us that the strongest driver is stable and fair rates, but interestingly, and surprisingly, Manitoba Public Insurance has not tested with Manitobans, how they define stable rates and whether the concern for stable rates relates to rates on average, or to the experience of individual ratepayers.

MPI polling both historic and current tells us that another important driver of the value proposition is the cost of vehicle insurance.

Interestingly, given the avowed purpose of the RSR, and one (1) of the stated purposes of the Capital Maintenance Provision, i.e., to avoid rate shock, Manitoba Public Insurance has no formal definition of rate shock. Mr. Johnston puts the -- a 5 percent assumption into the DCAT but was quite frank that there's no formal corporate definition.

Mr. Johnston was also frank, and our clients share his view, that rate shock is an individual experience. It's not an average. And he tells us at transcript page 838 and 839 most consumers are concerned about their own bills, a 5 percent increase, he can relate to may be tough to swa -- swallow for consumers.

So using that proxy for rate shock, that 5 percent rate increase proxy, we can conclude based upon the record of this hearing that over three hundred thousand (300,000) vehicles will increase their rates by over 5 percent. Twenty-five -- about two hundred and ninety thousand (290,000) will experience a premium increase of between 5 and 10 percent. Another forty thousand (40,000) between 10 and 15.

And whether you look at it in percentage terms or increases over $50, either perspective, that accounts for more than 25 percent of vehicles.

And the Capital Maintenance Provision is making a significant contribution to the rate shock experienced by those three hundred thousand (300,000) vehicles. And Mr. Johnston -- I didn't even have to ask him, he volunteered, let's say we didn't do the Capital Maintenance Provision which may be what -- which may be what you're interested in, that would shift down premiums by about 2 percent.

So in this section of our submissions, our client recommends two (2) findings to this Board; one (1) that rate shock is an individual experience not an average; and two (2), that over three hundred thousand (300,000) vehicles where -- will experience rate shock level increases if the rate -- rate application is approved with the CMP or Capital Maintenance Provision load being a significant factor.

In part 3 of our submissions, we turn to ensuring that forecasts are reasonably reliable. There's all sorts of forecasts that go into the MPI application, but not surprisingly, our focus will be on the interest rate forecast.

And My Learned Friend, I'm not mentioning whose birthday it is today, but My Learned Friend Ms. McCandless asked the -- the critical question in this hearing on interest rates. Recognizing that the Board last year rejected a fifth -- naive forecasts and approved a 50/50 forecast, she asked, on or about transcript page 365, What change in circumstances or new evidence is the Corporation aware of that would support its position in the use of the naive interest rate forecast, what has changed since last year?

And there was a brief pause, as reflected in the transcript, and then Mr. Johnston candidly said, I'm struggling with the right answer. And Mr. Giesbrecht suggested that there is not really any significant change, in terms of the environment of the marketplace.

Our client megs to differ. In our clients' view there have been significant changes in the marketplace, which cast additional doubt on the naive interest rate forecast.

First, there's been a maintenance and an enhancement of rapid US growth. Over the last two (2) years, the Bank of Canada also has moved up its overnight rate, its policy rate has moved upwards five (5) times and twice in the last four (4) months.

There is general acknowledgment, thirdly, that the Canadian economy is approaching full capacity. There's also lowered trade tensions with United States and as the Bank of Canada has made palpable and evident both in its conversations in

September and its overnight policy change in October, its concern about inflation has been made more palpable as is its willingness to increase rates.

And take a look at -- if -- if you have the chance and they're both referenced on the record, those Bank of Canada news releases, whether in July or whether in October and see the word "gradually" disappear from July to October. There's a message there for ratepayers and for forecasters.

Dr. Simpson has not tres -- tested for a structural break in the statistical information, but he was asked by PUB counsel whether this latest pattern is a meaningful departure from that of earlier periods. And he said, yes, there's no question the period of low policy rate and low interest rates has ended. The overnight rate or policy rate has begun to rise. The economy is moving towards capacity.

And listen to the comments of Stephen Poloz, P-O-L-0-Z. It's pretty much considered to be at capacity now and underlying tier inflationary pressures are beginning to drive concerns that interest rates need to be higher. And it's bounced around a bit, but we know in July it was 3, 2.8 in August, down to 2.2 in -- in September, but there's been some bouncing around in terms of inflation and the actual level has been higher as well.

And as Dr. Simpson observes, this material change in circumstances is actually been reflected in the forecasting performance of the -- the different approaches, whether it's standard interest rate forecast, the naive or the 50/50.

Again, not testing statistically for a structural break, but it's palpably apparent that the SIRF, Standard Interest Rate Forecast, has clearly outperformed the naive. And his expectation that the naive going forward is going to be an understatement of interest rates.

And at the bottom of this slide, being slide 35, he underlines two (2) important points about the results of the naive forecast over the last couple of years. One (1) is that its errors have been considerably larger, but also -- he didn't use the word bias -- but they've also been consistently in one (1) direction, in the direction of underestimating interest rate growth.

It's interesting to look in terms of the advice of MPI external officials -- not officials, but external advisors on interest rates. Before this Board, we've actually only had one (1) external expert from M -- presented by MPI who spoken to the issue of interest rate forecast and that was Dr. Cleary -- Cleary, C-L-E-A-R-Y, in 2016. And his advice was to adopt the 50/50 approach and that's found in a CAC exhibit with Slide 17 and 18 repeating that advice.

Dr. Chang has spoken of the naive forecast, but only in the context of his DCAT or Dynamic Capital Adequacy Testing investigation. And he specifically, in response to Information Requests of the Board, indicated that he was not speaking in terms of the naive on a basic ratesetting context.

Mercers also had an interesting comment about the naive forecast. Again, I want to be clear, this is not in the rate-setting context, it is not in the Dynamic Capital Adequacy Testing comment, it is in the context of the asset liability matching context.

And I asked Mercers perhaps the silliest question on the record of this hearing. When you're doing asset liability matching, why aren't you doing that analysis, assuming that interest rates stay flat? And certainly if the Board was observing the Mercer's witness they could observe his facial reaction to my silly suggestion. But he responded:

> "We would not recommending (sic) doing analysis assuming interest rates stay flat or constant."

And I asked him why not? And he shared with us the expectation, the consensus, of Mercers their standard interest rate forecast which all their investment professionals or actuarial professionals rely upon and which is assuming that there will be a gentle rise in the yield curve over the next few years returning to equilibrium. That's the Mercer's view.

I do want to be clear that this standard forecast of Mercers, their national assumptions, were not what Manitoba Public Insurance used or Mercers performed for Manitoba Public Insurance in the context of its asset liability analysis, but that's the Mercer's consensus. It's definitely not naive.

Both Mr. Guerra and Mr. Watchman pressed Dr. Simpson on his recommendation; that's at Slide 28 of the PowerPoint. And generally, Dr. Simpson concluded that the SIRF, the Standard Interest Rate Forecast, is better than the naive and that it should be -- certainly be part of the interest rate forecast. He also concluded that the existing Board Order for 50/50 is certainly better than the naive,

Dr. Simpson did make -- express some caution in his -- in his recommendation, reflecting a bias to the Board's Order from last year, which was

50/50, not standard interest rate. And as he says in the second bullet on this page:

> "If I were allowed to pick weights, they probably wouldn't be 50/50. I'd give more weight to the SIRF."

And, again, on transcript pages 1320 to 1321, he also notes the impact of the most recent Bank of Canada change in the over -- overnight rate and -- and indicated, again, an increasing affection analytically for the Standard Interest Rate Forecast.

During this hearing we've heard a lot from Manitoba Public Insurance about its alertness to interest rates, whether it's duration mismatch risk or -- or pricing risk. And if one were not familiar with the history of this Board with Manitoba Public Insurance on interest rate issues, one might form the impression erroneous, in our clients' submission, that MPI has vigorously been responding to interest rate risk.

The evidence of Mr. Johnston on this point is helpful. One (1) of the things he pointed out at about page 661 of the transcript was when the great recession hit, as we start to struggle with -- with challenges relating to historically low interest rates or certainly historically low outside of the great depression, that Manitoba Public Insurance was ill-equipped from a financial modelling perspective to confront the unexpected changes to interest rates.

And in fact, up until certainly 2010, '11 or '12 didn't even have the capacity to model interest rate impacts. Our client believes that based on the record of this hearing and prior Board Orders, it is reasonable for this Board to conclude, and appropriate to conclude, that unlike the implicit assertion of a vigorous response to interest rates that it's reasonable to conclude that the PUB has had to push MPI over the years to address the asset liability mismatch;

To cease gambling on that mismatch in the hopes that interest rates would rise;

To improve protection specifically for Basic as opposed to a corporate portfolio;

To provide a new and regular asset liability manage study -- asset liability management study, rather than the compromised Aon study;

And to provide a new asset liability study on a timely basis.

And that history of those efforts by the Board are captured in CAC Exhibit 16.

But if you look at slide 31, you see

the Board expressing the view in 2013 that Hy -- Manitoba Public Insurance's approach to duration mismatching was making it too vulnerable to interest rate risk.

2014, advising MPI to substantially imus -- immunize itself from changing interest rate risk.

Ongoing concerns in 2016 and in 2017 expressing frustration with the failure by Manitoba Public Insurance to produce an updated asset liability matching study as ordered by the Board.

In the area of forecasting, our client recommends two (2) findings to this Board. First, that Manitoba Public Insurance has not discharged its onus to demonstrate that the naive forecast should replace the 50/50 forecast for ratesetting purposes.

Secondly, that there has been a material change in circumstances over the last two (2) years, suggesting that greater reliance should be placed on the Standard Interest Rate Forecast than the naive forecast.

In the discussion of ensuring that actual and projected costs incurred are necessary and prudent, our client is going to address four (4) issues and, certainly, Mr. Chair, just from a timing perspective, I expect to be done with my colleague Ms. Dilay this morning. What I would recommend is once we get done Section 4(a), we take a look at the clock and 4(b) would take about fifteen (15) minutes, I suspect, but we take a look after 4(a).

From our clients' perspective, there are four (4) critical issues relating to prudence and reasonableness in this hearing.

First, and most importantly, is the proposed Manitoba Public Insurance investment portfolio for Basic and for pensions biased in favour of short-term rate stability at the risk of higher long-term rate instability and at a cost to consumers in terms of foregone opportunities and in -- in -- and in terms of higher rates.

Secondly, are Manitoba ratepayers facing current and ongoing pressures as a consequence of the Corporation's passive approach to long term -- in brackets -- (complex claims management) in the aftermath of the BI3 project.

Three. Are information technology staffing budget levels excessive as compared to relevant peers.

And finally, did MPI imprudently manage large invest -- information technology projects related to physical da -- damage re-engineering and the customer claims reporting service, which is a subset of that PDR initiative.

Starting with asset liability matching. I want to start out by being agreeable and there are certain things in which there is consensus from our clients' perspective, at least between Mr. Viola and Mercer and, in some cases, even with -- I see I've misspelled Mr. Johnston's name here and I apologize for that, Luke, on slide 36. I've got it right almost every time.

(BRIEF PAUSE)

THE CHAIRPERSON: Sorry, to interrupt, Mr. Williams.

DR. BYRON WILLIAMS: And I want to start with liability risk because good practice, best practice, tells us that modern portfolio management starts not with the assets, but with recognizing the risk inherent in the liabilities and seeking to measure those risks. So what is the liability risk associated with the Basic and pension liabilities?

And one (1) of them highlighted both by Mr. Viola and by Mercer, by Mr. Makarchuk, relates to the fact of the long duration -- the -- the long cash flow timeframe of many of these liabilities.

And at slide 36 I -- I -- I pulled statements -- quotes, as well as paraphrases, for Mr. Makarchuk. A lot of the cash flows we're worried about are longer than ten (10) years. Roughly half of them are shorter than ten (10) years, and roughly half of them are longer than ten (10). Some claimants are still quite young. Tragically, some of these claims could last as long as fifty (50) years.

Mr. Johnston affirmed Mr. Makarchuk's rough math, pointing out that 48 percent of total ultimates paid for accident benefits weekly indemn -- indemnity and, indexed in some fashion, element of the personal injury protect -- protection plan extend beyond ten (10) years, 48 percent.

And then when we -- if we look at accident benefit Other which is indexed, 39 percent of the total ultimate paid is ten (10) years and beyond. And it's not just the cash flow well out in the future ten (10), twenty (20), thirty (30) years that is concerning, it is the relationship that they're linked to inflation.

And Mr. Makarchuk points out, it's at page 313 of the transcript, many of these obligations were linked to future inflation and Mr. Johnston confirmed that. A significant portion would be tied to Manitoba CPI. Some are tied to the industrial average weight -- wage, but I would say the vast majority would be income replacement benefits indexation.

Long cash flows well beyond ten (10) years, inflation indexed, a central concern about -- of Mr. Viola in terms of defining the liabilities. His conclusions affirmed here by both Mercer and by Mr. Johnston.

How do we go about appropriately addressing these risks? There is agreement by Mr. Viola, by Mercer, and by the Canada Pension Plan Investment Board that a critical first step is that minimum risk or, for the purposes of this conversation, the liability benchmark port -- portfolio.

The first bullet on this page, we quo -- we quote from Mr. Viola's PowerPoint saying that this is the first step. In the second bullet, we note the approach of the Canada Pension Plan Investment Board. MRP, the Minimum Risk Portfolio, otherwise known in this hearing as liability benchmark and -- and how they do that, interestingly, with the RRB index.

And then we have Mr. Makarchuk. One (1) element is development of a liability benchmark portfolio as a proxy for liabilities and perhaps the most important five (5) words in this conversation, six (6), "to identify and measure the risks" because that is the purpose of this liability benchmark, expressly said by Mr. Viola and by Mr. Makarchuk.

Identifi -- identify and measure the risks of the liabilities. It is not a trivial exercise, it is not an exercise to be conflated with capital mark -- market exc -- assumptions, it is the exercise to identify and properly measure to the best of our ability the risk, the liabilities.

Mr. Viola says that risk-free assets should reflect risks in the liabilities, duration and inflation. Makarchuk says, and this is the same point but at a -- at a different transcript page, page 624 now:

> "The liability benchmark portfolio is for the purpose of identifying and measuring risk."

This is not an investment decision. This exercise is intended to be a reflection to the best of our abilities of reality. What does Mr.

Makarchuk say? We are trying to find a liability benchmark that best represents the obligation, not a simplified assumption that best represents the obligation.

Mr. Viola and Mr. Makarchuk warn us. Do not conflate the design of the liability benchmark with the ultimate portfolio selected. And that was the source of some confusion in My Learned Friend's cross-examination of Mr. Viola on -- on Monday because the questions -- it was unclear whether they were being directed to the liability benchmark, or the ultimate portfolio. Those are two (2) distinct analytical steps, both critical, but both about different things.

Mr. Viola adamantly confirms that the liability benchmark composition should not depend on capital market expectations. And in my conversation with Mr. Makarchuk he pointed out, set out the liability benchmark portfolio and then realized that the ultimate choice in optimizing the portfolio may not be to invest in the same assets, but you've got to go through that distinct exercise, identify and measure your risk, then optimize.

And I put to him at pages 641 and 642, it's important to maintain analytic distinction and he confirmed that. The liability and moder -- modelling decision is separate from the asset class investment decisions. It's not an investment decision. I'm putting my words on his statement that -- that last statement, just -- just so I'm clear.

But you can see the careful distinction he draws in this sentence being a quote from pages 641 and 42 of the transcript.

> "The liability and mode -- modeling decision is separate from the asset class investment decision."

Both Mr. Makarchuk for Mercer and Mr. Viola confirm that this benchmark is critical to the outcome of the optimizing exercise. Makarchuk says it's an important foundation. We're paraphrasing Mr. Viola here, but on a number of occasions in his conversation with My Learned Friend on Monday, he noted that the optimal asset allocations that flow from an optimizing process depend materially on whether a nominal or real liability benchmark is selected.

Our clients' view buttressed heavily by the evidence of Mr. Viola which we rely upon, is that risk has been mis-identified and mis-measured in the nominal liability portfolio, and that -- that mis-measurement of risk is material.

Mr. Viola highlighted in his PowerPoint and oral comments that big simplifications, using his words, of MPI and Mercer. MPI focusing on the expected level of inflation rather than the volatility of inflation and Mercer's carefully hedging its support by saying it was driven by its views of expected level of future inflation than volatility.

But as Mr. Viola points out, and as -- as Mercer implicitly pointed out when they went through the volatility calculation with me, risk depends on volatilities and correlations, not levels and averages.

And, surprisingly, given the importance of this decision, MPI did not ask Mercer to test the basis risk, the tracking error that might in er -- that might flow from this material simplification. When pressed by our client in CAC-MPI-2-3, Second Round Information Response, Mercer confirmed a 4.5 percent tracking error and admitted it was material.

And that materiality, that 4.5 percent, can be juxtaposed at the volatility or risk in -- in MPI's current portfolio of 3.8 percent. A 4.5 percent error is significantly larger, a hun -- 18 percent larger.

One can profess to have a low risk tolerance but suggesting what has a low risk tolerance by assuming away real interest rate risk or long-term inflation risk, does not demonstrate fidelity to the id -- the idea or the value of less risk.

Mr. Viola says at page 1460 of the transcript:

"By not con -- capturing this inflation risk properly, we're not properly measuring the true risk of having nominal bonds support real liabilities."

He describes the MPI process for defining contents of its risk-free bus -- bucket as very questionable.

And if you look to his PowerPoint Slide 17, you'll see the conclusion of Ontario Teachers again, albeit about a deck -- a decade and a half ago in terms of inflation linked assets of long duration. What is their main source of liability risk; a drop in real interest rate risks -- rates? It was true fifteen (15) years ago. It's true today. And when we have long-lived inflation linked assets, it will be true twenty (20) years from now. So is our clients' submission.

A critical conversation in this hearing was the conversation of Manitoba Public Insurance with Mr. Viola about modelling liabilities. And at page 15/16 of the transcript, a very important quote. You see a suggestion by Mr. Scarfone, My Learned Friend, that the decision to model liabilities using a real liability benchmark versus a nominal was an investment decision. And Mr. Viola vehemently disagreed.

The liabilities are what they are, regardless of how you decide to take risk to them. It's not an investment decision. It's a reflection of reality. Again, I'm paraphrasing or sharing my inference from that -- that statement.

And Mr. Viola -- and this was highlighted in his conversation with Board Counsel, highlights the fact that the focus on nominal interest rate risks misses the greater risk of real interest rate risk and long-term inflation risk. He draws the analogy to an investor in stocks focused on the dividend rather than the really risky issue related to the capital gain.

He highlights the changes in real yields are important because of the longer horizon, and that nominal bonds would do poorly if inflation is more volatile or higher than expected.

I want to go back to the issue of risk basis or tracking error basis risk, excuse me, and highlight the fact that until our client made this inquiry, tracking error was not considered. And tracking error, as I understand the concept, and as confirmed by Mr. Makarchuk, measures the variation in future returns. In this case, Mercer was asked to measure that variation in the future returns between the nominal liability benchmark and the real liability benchmark as via the anticipated volatility.

And when we put to him on behalf of our clients, whether he had conducted that analysis for MPI, Mr. Makarchuk candidly agreed. I don't believe we specifically calculated the difference in the volatility between the two (2). Tracking errors were not analyzed or presented until the response to CAC Information Request 2-3.

As Mr. Viola confirmed, that 4.5 percent is a big number. And in our client's respectful submission, recognizing the long-term risk associated with long-duration inflation linked assets, Manitoba Public Insurance is taking a material gamble in the design of its liability benchmark portfolio by ignoring real interest rate risk and long-term inflation risk. It is misidentifying and mismeasuring risk associated with its liabilities.

This is an excerpt pulled from MPI Exhibit 44. It's a response of Mercer's. And if you'll recall our conversation with Mercer, we -- we took them to one (1) of the many attachments to Appendix 17. And this is the basis of the November 8 conversation that Mercer had with Manitoba Public Insurance. And you recall the slide, they talked about next steps being stress testing.

And during our cross-examination, we asked Mercer, did you do these stress tests? And they couldn't recall. So they did an undertaking, and what they indicate was that they were planning to first proceed with three (3) of the six (6) scenarios. Unfortunately, we were unable to complete the stress tests in advance of the meeting November 28th, and there were some quality control issues with the first three (3) stress tests. So given that the investment committee meeting had occurred, and given concerns regarding overall modelling cost -- costs, peer reviews of the results were not completed, and the results were not finalized.

Now, for the purpose of the Exhibit 44, some additional analysis was completed a year -- almost a year after the time when it would have been useful. And certainly, our client would invite the Board to look at the inflation shock scenario. But the important point, from our clients' perspective, is that important due diligence, that important peer review, that important stress test was not enter -- undertaken.

And if you couple the failure to test for tracking error, given the monumental importance of this decision, and the failure to undertake stress test scenarios as recommended by Mercers, in our clients' view, that demonstrates an imprudent, unreasonable approach to the asset liability assessment, and it represents the undue haste in which this study was conducted.

And if the Board directs its mind back to last year's Order, or the year before that, there was considerable tension around the fact that an Asset Liability Management study was not conducted. MPI didn't have time. And then lo and behold, September, October, November of 2017, when it didn't have time previously, it acted in haste and did this analysis. It acted in haste, and it did shortcuts, material shortcuts inconsistent with good practice.

Real return bonds. I'm moving now from the liability benchmark, which is really the -- that mis-measurement -- that misidentification of risk is fundamental to our concerns, but we've set our liability benchmark. Now we're moving to optimization.

On slide 49, our clients are simply trying to make the point that real return bonds are not a dirty word. We see Teachers, probably the best-regarded pension fund definitely in Canada, but earning worldwide renown. A long-standing commitment between -- to -- between a significant portion of real return bonds, the last two (2) or three (3) years between 60 and 19 percent.

And in Exhibit 29, which was filed collaboratively with MPI yesterday, if you -- if you get a chance to go back to that couple of pages from the Teachers' annual report in their website, take a look at what they have done with that $185 billion portfolio. There's a significant commitment to real return bonds in the range of $20 billion.

We'll look at the other inflation hedges there, as well, the not 8.9 million -- 8.9 billion inflation hedge, the very significant real assets in addition. Do the math. We suggest you'll probably come up in the range of $40 million in terms of inflation hedges, some real rib -- return bonds, some the inflation hedge, some the real assets.

A sophisticated investor, not wishing away real return risk, but recognizing that it's a fundamental risk to portfolios that are indexed and that have long duration. That doesn't mean that's the right mix for Manitoba Public Insurance, but it raises questions.

We point out as well that the SAAQ, I can't pronounce the acronym, perhaps My Friend, Ms. Dilay, will tell me over the coffee break, but that's the public insurer in Quebec. Their investment portfolio has about 10 percent as of December of 2017, if memory serves me right.

And we have the advice of Mr. Makarchuk. Real return bonds are an excellent way to ensure you get real return, if you're worried about real return. And if you're running a portfolio of a significant duration with significant indexing risk, why wouldn't you want to have at least some protection for real returns?

And when we turn to the Mercer model, when we returned to MPI Exhibit 15, when it modelled upon an appropriate measurement of risk the real liability benchmark, Mercers concludes, assuming a real liability benchmark for modelling, removing real return bonds significantly reduces an opportunity for improvement at lower risk levels. Opportunity for improvement at lower risk levels.

And Mr. Viola estimates that at the current risk levels, that volatility of plus or minus -- or excuse -- that volatility of 3.8 percent, Mercer's efficient frontiers suggest that the expected excess return above the liability benchmark drops by around .8 percent when RRBs, real return bonds, are removed. Point eight (.8) percent on a portfolio of the size of Manitoba Public Insurance's is a big deal.

And when pressed on the value of a real return bond, Mr. Viola commented:

> "With a break-even inflation of something south of two (2), even if you're getting inflation of two (2), which is what the Bank of Canada assumes, you're actually doing better by buying the real return bonds."

And that break-even inflation rate, you may recall in my cross-examination of Mr. Makarchuk on that point, we looked to the -- how they calculated that break-even inflation rate, and comparing real return bonds to long federal bonds, the thirty (30) year bonds.

The diligent work of Board advisors in their Information Requests also highlighted another very significant concern with the current MPI approach to asset liability matching, and their expectations for the investment portfolio.

In our clients' view, Manitoba Public Insurance is gambling that its external experts' preferred interest rate forecast is wrong. Mercer's Standard Interest Rate Forecast, which we talked about earlier, the one (1) used by its experts and actuaries across Canada, was not accepted by Manitoba Public Insurance. Instead, a forecast based upon the fore -- forward curve was substituted to be more in line with MPI's business model, in the words of Mercers. I'm not quoting them directly.

And as I suggested in my discussion with Mr. Makarchuk, use of Mercer's Standard Interest Rate Forecast por -- portrayed capital losses for the fixed income holdings. And that information is best indicated at slide 52. Again, at the top of that slide, we're talking about what Mercers prefers, their Standard Interest Rate Forecast.

And Monday, we had a conversation with Mr. Bunston. I think it's Appendix 17, Attachment E, slide 14 or 13. The expected ten-year return about -- of the nominal liability portfolio, assuming Mercer's best estimate, was 2.1 percent. Take out the external expert's best estimate, substitute the forward yield, and the expected ten-year return of the nominal liability portfolio -- this is in 17, Attachment A -- with MPI's substi -- with MPI's substitute view grows to 2.8 percent. If you look at that difference in expected outcomes, point seven (.7) divided by two point one (2.1), a 33 percent difference, flowing from that rejection of the external experts' preferred view.

That is concerning to our client. Ultimately, Mr. Viola questioned the premise that the so-called risk-free bucket of MPI was risk-free, and concludes that it has material risk over the long term.

There are two (2) key challenges, the first being the minimum risk portfolio, the nominal liability benchmark, is fundamentally compromised by misidentification, and mis-estimate of risk. The portfolio understates the risk of inflation and real interest rate risk.

And secondly, that liability benchmark analysis was compromised by MPI introducing capital market expectations into the analysis.

As Mr. Viola pointed out, liabilities define themselves. They are what they are. They are not a function of risk tolerance. The decision to accept or hedge risk is a separate decision. That's for part 2, the optimization process. He describes that portfolio, and that approach is questionable, very questionable.

In terms of why our client concerns -- concludes that the MPI bucket is a risky bucket over the long term, remember the simple truism of Mr. Viola that any constraint shifts the curve. What are the elements of higher risk? No real return bonds leads to poor liability protection against unexpected inflation, real -- real rate risk, and less effective duration management.

And in this context, Mr. Viola makes an important point. And this was in his discussion with My Learned Friend, I believe on -- on Monday -- it might have been with Mr. Watchman yesterday. MPI, in its rebuttal, did do some stress testing, pulling from a -- a DCAT analysis, a 3 percent inflation assumption for four (4) years. And our client, in the context of the DCAT, actually thinks that's a good, solid analysis, because the DCAT isn't about whether we compare our liabilities twenty (20), or thirty (30), or forty (40), or fifty (50) years from now. The DCAT is simply about: Do we have enough reserves to prevent rate shock? And it's only over a short time horizon. We're looking out to 2022 appro -- so that kind of a modelling assumption for the DCAT is quite good.

But Mr. Viola, in conversation with Mr. Watchman, said, It's not -- the risk isn't in 3 percent inflation for four (4) years. The real risk for an inflation-sensitive portfolio with roughly half its liabilities beyond ten (10) years is over a longer duration, even at a lesser amount.

Another element of high risk with the Basic portfolio is the absence of other real assets, such as real estate and infrastructure, and therefore, less diversification. Instead, what we have is real rate risk, inflation risk, credit risk, and some illiquidity risk through the MUSH bonds, concentrated in the fixed income portfolio.

From the big picture, from the total portfolio perspective, Mr. Viola points out that they're -- that instead of concentrating risks in fixed incomes, a combination of low risk assets and other risky assets gives better risk/return trade-offs than being concentrated in either one (1) of the buckets. Excuse me. Thank you.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Mr. Viola again flags the concern that MPI's focus on short terms -- rate stability, and that their opportunity cost with the short-term rates focus in terms of better returns over the long run, but also that there are risks of higher long-term rate instability.

Just a couple of last points on investment issues. It is open to this Board to -- to ask itself whether in the course of this hearing, Manitoba Public Insurance has demonstrated a mastery of these complex issues. And Mr. Viola yesterday pointed out the inconsistency between the MPI explanation of its modelling exercise, of Mercer's modelling exercise in its rebuttal, versus the Mercer response found in Exhibit 38.

And at slide 57, we had a conversation with one (1) of the MPI witnesses, again, over the affidavit filed in support of our motion for better disclosure. And again, you see some challenges in terms of grasping some of the issues.

Initially, the real liability benchmark was described as having a much higher risk of three (3) -- three (3) -- it says here "perfect," but it should say 3 percent, and that assessment was amended in a subsequent affidavit to suggest real liability benchmark with the risk of zero percent. And again, you see MPI correcting its conclusion originally that the real liability benchmark was -- was higher, but suggesting in its subsequent analysis that, as compared to the selected nominal portfolio, the real liability benchmark was lower.

Frankly, our client has a bit of a challenge with this whole conversation, because in essence, one was comparing a liability benchmark based upon real interest rate risk versus a optimized portfolio based up -- flowing from the nominal liability benchmark. So that suggests a conflation of the issues that our -- our client is -- is quite uncomfortable with.

Finally, I want to go to expertise. Mr. Viola is a -- a well-known leader in this field. It's instructed that many of the recommendations he made back in 2016 have been accepted, and the idea of segregating between Basic and -- and pension is certainly something that he promoted. He comes out of great roots, out of Teachers in the 1990s, and then as a young vice-president at the Canada Pension Plan Investment -- Investment Board; very sophisticated investors. And their current firm, Cortex, obviously is a highly regarded North American practice.

Mercer certainly has good qualifications, but their role in this process has been circumscribed. Their best estimate of future interest rate risks were rejected. They did not test for tracking error, or basis risk, and the scenario testing was not undertaken. And if you look at their careful hedging of their words, in terms of the nominal liability portfolio, their analysis was compromised by assuming away long -- long-term inflation risk and real interest rate risk based upon the inflation level rather than inflation volatility.

Our client has no doubt about the -- the capabilities of the MPI Board, but they were cons -- clearly constrained in the inputs, in the haste in which this exercise was conducted, in the challenges that Manitoba Public Insurance demonstrated in coming to grips with the purpose of the liability benchmark portfolio, and with the ultimate mis-measure and misidentification of risk. So certainly, while our clients greatly respect the members of the MPI Board, they were not here testifying, and they are limited by the quality of information and the quality of the asset liability analysis.

Ultimately, our client concludes that the proposed approach by Manitoba Public Insurance is a significant gamble. Again, the assumption to assume away real interest rate risk, and also substituting MPI's judgment for the best judgment of Mercer in terms of future interest rate forecasts.

Our client recommends the following findings: Ultimately, that -- that the asset liability management analysis was not conducted in a reasonable and prudent manner, first of all, in terms of its assumptions, the assuming away of -- of real interest rate risk and long-term inflation risk;

The failure to test for tracking error between the real and nominal benchmark portfolios;

The insertion of capital market assumptions into the liability benchmark analysis, when that properly belongs in the second stage of the analysis;

The optimization, and the failure to undertake the Mercer-proposed risk scenarios, at least the three (3) prioritized ones.

In terms of the construction of the

analysis, our clients submit that it is not prudent to substitute the opinion of MPI for the best estimates of its experts regarding future interest rate risk, and it is not prudent to concentrate risk, inflation, credit, and illiquidity within the fixed incomes in the Basic portfolio rather than to diversify the sources of risk via real assets as well as equities.

Ultimately, our client observes that there are significant risks of long-term rate instability, as well as the likely prospect of lower returns associated with MPI's preferred approach.

Mr. Chair and members the panel, I think that's a -- a useful break point, but I can -- I could proceed for another twenty (20) minutes, if you would prefer.

THE CHAIRPERSON: No. We'll take fifteen (15) minutes. Yeah. Thank you.

--- Upon recessing at 10:20 a.m.
--- Upon resuming at 10:42 a.m.

MR. STEVE SCARFONE: My apologies, Mr. Williams, I was stuck waiting for an elevator for ten (10) minutes.

THE CHAIRPERSON: Oh, that's -- that's

unimaginable in this building, Mr. Scarfone.

I don't know if I'm supposed be looking at Mr. Williams or Ms. Dilay? Mr. Williams, okay.

(BRIEF PAUSE)

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Question 4(b) at Slide 61 of the PowerPoint is whether MPI ratepayers facing current and -- are facing current and ongoing rate pressures as a consequence of the Corporation's passive approach to long terms claim management in the aftermath of BI3.

And before we leave this slide, I'll cut to the chase and the answer is yes. And our -- our client does have concerns with how the Corporation has addressed complex claims, but we also should acknowledge the role of the MPI actuary in candidly flagging this concern to the Board and for those who have been at this Board for years, this certainly has been candidly discussed and -- and raised by the MPI actuary and our client acknowledges his -- his role in -- in identifying this issue so that stakeholders and the Board could better understand it.

On slide 62, these -- these bullets are

from an appendix to CAC Information Request 1-36(a). It's the response to the -- that Information Request and that I can't do justice to the issues as well as this briefing to MPI management in April 2018 does but I want to flag some of the observations that our client has, or that -- that -- that are captured in this briefing note.

We date the BI3 era to about 2010 and the narrative that has played out in hearings over the last few years is that claims -- there's -- as compared to expectations prior to 2010 or so, there's an increase in these complex claims. These claims under the personal injury protection plan lasting more than two (2) years.

There are a number of factors influencing this growth in retain clams -- claims; one (1) is the world outside, which is be -- to some degree beyond the control of MPI. Another is the implementation of the BI3 initiative and the challenges MPI experienced in delivering it. And finally, there was a reduction in staff because BI3 was supposed to relieve the burden of claims management using technology but in -- indeed, the challenges have been twofold since then.

One (1) is that claims managers weren't

-- were struggling to properly reserve claims but, more fundamentally, there was also struggles in managing claims.

One (1) of those external factors, at least to some degree, is also a very significant increase in claims with psychological factors by 10 percent. And we flagged this because this is one (1) of the critical sources of ongoing rate pressure for Manitobans.

The briefing note found at Appendix -- to CAC-1-36, Slide 8, flags challenges in claims management, and reserving flowing from the BI3 initiative. Claim staff were cut and also were not proactive in recoveries.

And as Mr. Johnston confirmed with me in our conversation on -- on October 18th, claims that last longer, all other things being equal, mean more cost to the Corporation. And one (1) of the challenges MPI faced and has faced since 2010 were process char -- changes as outlined in the first paragraph on Slide 65 that created a more passive approach to injury management.

And Mr. Johnston, again, at the bottom this -- this slide talks about less agre -- aggressive claims management being employed.

And as he pointed out in a conversation around page 862 of this transcript, instead of being addressed it inta -- intake complex claims were only being actively managed in the later stages of the claim. And again, highlighting the cost to ratepayers and to the individuals affected of this passive approach.

On slide 67, this is again an excerpt from the briefing of the to -- to MPI leadership, noting that the majority of the current case matters came from a physical damage background and were challenged to manage the complexity of claims.

Now, there have been efforts by Manitoba Public Insurance to respond to these challenges in terms of the reserving challenge. There was the centralized reserving unit and there also have been efforts to more assertively manage claims and at an earlier time.

One (1) of the important elements coming out of our conversation with Mr. Johnston on October 18th was, to date, in terms of those long-term claims, despite the efforts of Manitoba Public Insurance, in terms of the concerns that the actuary is most concerned, with the longer-term, I'm not seeing any substantial improvements at least to date.

From our clients' perspective, this is an important issue to monitor to ensure that MPI continues to try to be proactive and also to acknowledge that a passive approach dating back to 2010, at least to 2017, it -- has imposed injuring costs for Manitoba ratepayers.

One (1) of the important initiatives that Manitoba Public Insurance is undertaking is -- is -- is how to better track and benchmark these claims. And they indicated that -- that benchmarking framework was being created and would -- could be shared for the next General Rate Application.

And so our client on this issue is recommending that the Board find that Manitoba Public Insurance ratepayers are facing current and ongoing rate pressures as a consequence of the Corporation's passive approach to long-term claims management in the aftermath of BI3.

I hasten to add, as we've noted in an earlier slide, that there are other factors in play, including the growth and challenges with psychological issues, but that passive approach, the evidence, on this record, is suggestive of an adverse finding in this regard.

We're going to skip Slide 71, because I

don't want to steal Ms. Dilay's thunder when it comes to making recommendations.

We asked the very simple question at Slide 72 whether information technology staffing budgets are excessive as compared to relevant peers, and certainly rely upon the bar -- Gartner Group benchmarking exercise and as outlined in the cross of Board counsel, at least as we understand it, MPI spends about 62 percent of its IT budget on personnel as compared to 45 percent for peers.

Similarly, there is a disproportionate amount of contractors within the MPI IT staff. So this will be the shortest section I ever comment upon, our recommended finding in this section is that as compared to peers Manitoba Public Insurance information technology staffing budgets appear excessive.

We turn at slide 74 to a larger -- a longer section relating to physical damage re-engineering and a subset of that project, the Customer Claims Reporting Service, CCRS. And our client would acknowledge and was pleased to note that we are starting to see at Slide 75 a modernization in terms of the approach that MPI is attempting to bring to man -- management of complex projects.

But our client cautions about offering too many plaudits for this. Coming to decent good practice in 2018 when that insight should have been available long before that is encouraging but it -- it's not like that the approach that Manitoba Public Insurance is currently seeking to employ is -- is -- is excellent as compared to industry standards.

Indeed, Mr. Wennberg candidly pointed out that they're basically trying to get to an industry standard approach in terms of these big projects; that there's going to be some rigour and that MPI executive management have to be accountable for the net present value integrity in that -- for the integrity of that analysis. Those are all laudable but certainly should have been in place long ago.

Our client observes that failed projects have real impacts on retained earnings, on foregone opportunities and in the waste of ratepayer money. And in our discussion with Ms. Campbell on October 18th, she talked and made the point that when we use words like "impairment" and "write-offs," what that means is a reduction of equity. And we have seen focus in the '17/'18 year an impairment of deferred development costs in the range of $20 million equity, all other things being equal, is 20 million lower.

And this connection may not have been made in Manitoba Public Insurance's mind, but I assure you that our client has noted the -- the figure associated with the Capital Maintenance Provision of $20 million.

And in our clients' mind approving the Capital Maintenance Provision would be holding Manitoba Public Insurance equal for its mismanagement of important information technology projects. And I'll come to that more later.

Are these projects a failure? Well, the CCRS definitely is a failure. It has been written off. And Ms. McCandless noticed in her discussion with Mr. Remillard, on Slide 77, that's a $15.6 million write-off.

And Mr. Wennberg, moving from the CCRS to the broader project, a project that went from an estimated net present value of $18 million positive in 2016 to an estimated negative net present value, certainly, in the range of fif -- negative $50 million in 2018 described the PDR, the Physical Damage Re-engineering, as a very deep negative. In his conversation with My Learned Friend Mr. Scarfone. And that very deep negative quote can be found at transcript slide 9 -- Page 9 -- 19.

Another unreasonable imprudent element of current cost for Manitoba Public Insurance ratepayers in the 2018/'19 year is the eighty-one dollar ($81) premium for direct repair shops.

And as Mr. Wennberg noted, this type of premium payment is not undertaken by the Crown or private jurisdictions, and then when other Crowns and private jurisdictions proceeded MPI in implementing similar programs to direct repair, they did so without these premium payments. This is not the industry standard and -- and it is not a prudent expenditure. That agreement is up for renegotiation with the new agreement scheduled to take place early -- or at the start of the next fiscal year for Manitoba Public Insurance.

And I want to stay with the physical damage re-engineering because I spoke about how that failed project, that deeply negative project, takes money out of ratepayers' pockets, takes money out of retained earnings, but it also is about lost opportunities around. Around page 1119 of the transcript, I have -- I started a conversation with Mr. Remillard, going back to 2014, because back in 2014, the magic -- the big -- the big ticket item within the Physical Damage Re-engineering Project was going to be this first notification of loss, now known as CCRS, as well as a replacement for the CARS, the CARS legacy system.

And you'll see a -- a quote at the top of this page from Mr. Graham saying we need to update our system. It's in dire need. With the -- initial conception of PDR back in 2014 was it -- it was going to take care of -- of the need to replace CARS. And if you go to the next slide, you'll see back in 2014 there was about 32.6 million in terms of optimize adjusting which included the first notification of loss and the CARS replacement. So about half of the total project cost.

So not only is it the money down the drain but the foregone years where Manitoba Public Insurance could have been addressing its challenges with CARS or legacy where in our clients' submission frittered away in this failed project.

Board counsel did an excellent job of forensically examining some of the roots of the challenges with the Physical Damage Re-engineering Project. And as we try to figure out what happened, which I think is important for today's ratepayers and future ratepayers, it's important to acknowledge that there seems to be a consensus, hardly a radical consensus, that when you're doing a net present value calculation, it should include operating costs,

And you see, Mr. Kenry (sic) for Gartner saying:

> "To do a fulsome MPV analysis, it should include operating costs."

And Mr. Graham, Chief Executive Officer of MPI, saying:

> "To the extent that business cases didn't include operating costs, he would find that surprising."

And the Chief Information Officer Mr. Bunko saying:

> "A full business case needs to include all the associate initiative, and ongoing cost for the program."

That begs the question. This is not radical. We could had this same conversation ten (10) years ago, frankly, twenty (20) years ago -- we might not have used the words "MPV analysis," but we would have known that operating costs had to be included.

So the question becomes: Were not concerns flagged within Manitoba Public Insurance in looking at these purported business cases and the absence of operating costs?

Mr. Remillard confirmed that major capital projects, many of them, did not include an evaluation of operating costs as part of the evaluation of the total cost of the operation.

And certainly Mr. Henry, on behalf of Gartner Group, observed that in the 2016 Gartner report, as well as the 2017 Gartner report, the net present value calculation was conducted but did not include operating and ongoing costs.

And our client suggests that this goes to a bit of a deeper question in terms of the relationship of external experts retained by Crown monopolies when they come before the Public Utilities Board. We can answer this question, but we wonder whether Gartner Group should have filed the MPV analysis knowing that a fundamental building block was -- was incomplete.

Gartner did acknowledge in the conversation with Public Utilities Board legal counsel that they should have been stronger in making the point that future analysis was required, and that was especially in the context of the operating costs.

Slide 87, and I'm not going to go through this because I think PUB counsels have done a very strong job of -- of doing that, but we've inserted it, just to look at the big picture reason to explain the mystery of how what looked like a relatively positive business case has gone so highly negative.

And in that conversation as captured at page 931 of the transcript, the big three (3) reasons are flagged there, and I simply, on behalf of our clients, put it forward for your consideration.

One (1) of the challenges the Gartner Group faced is identified in a conversation with the PUB Chairperson is that Manitoba Public Insurance unreasonably and imprudently failed to identify and disclose relevant information to Gartner Group; information relating to the ongoing costs, information relating to the eighty-one dollar ($81) premium.

And Gartner Group, at least, is -- is clear in its view that the obligation to provide the information given that it is not an audit firm rests with MPI and that's a reasonable conclusion from our -- our client.

The Chairperson explored this again as -- as captured in the conversation at page 90 and we see the efforts by Manitoba Public Insurance to explain the failure to provide this important information relating to ongoing costs, the eighty-one dollar ($81) premium, et cetera.

Our client wants to go back to the big picture. Witnesses for Manitoba Public Insurance testified that they regularly review Board Orders. The footprints for the significant concerns with this project are palpably evident certainly by Board Order starting in 2015. And here you see at pages 1126 and 1127 of the transcript, on slide 91, conversation with the Chief Information Officer of the Corporation flagging the concerns that were presented even before the first Gartner report by the Public Utilities Board in its decision.

And we put the question to this Chief Information Officer whether given that insight, given that he had read the report whether -- we suggested to him you were not concerned with the status of PDR in terms of the feasibility of its business case in 2015 and he confirmed he was not. And that is difficult for our client to fathom and to understand.

And it becomes more pressing in 2016 and we, again, took the MPI witnesses through the Chief Information Officer through the Board Order and refer them to page 37 with the PUB expressing its concern with the lack of business case and how met --

materially the scope of the PDR had changed.

And at the bottom of this slide being Slide 92, again, you see the Chief Information Officer indicating that those observations of the Board did not question -- cause him to question the viability of the PDR business plan, generally.

And to our clients that is difficult to understand. There were limits in the Gartner Group report, both in 2016 and 2017, but there were also important warnings. And as you see in our conversation with Mr. Henry at Slide 33, there were warnings in the 2016 and 2017 Gartner reports that ongoing support and maintenance costs were not included in the MP ev -- analysis.

And from our clients' perspective, certainly, the Board of Directors of Manitoba Public Insurance and senior executive had the opportunity to become knowledgeable about the PDR. The PUB decisions are publicly available. Certainly by 2015, definitely in 2016, there were significant warnings about PDR.

On slide 94 we've captured some of the warnings that were presented in the Gartner Group 2016 and 2017 reports about PDR. One (1) of the key risks is Mitchell's ability to deliver the expected outcomes of the FNOL project, now known as the failed CCRS project.

It entails the implementation of innovative and fairly complex accident file -- profiling approach new to the industry. Also, flagging concern are the reality that there was no estimate for ongoing support and maintenance costs.

Our client notes that Mr. Geffen on behalf of Gartner Group made a presentation to the audit, finance and risk committee in 2017 and as Mr. Henry confirmed, or Mr. Bunko I forget which, the status of the PDR project would have been an element of that discussion.

Board of Directors minutes from February of 2017, that's the last bullet on slide 95, also captured that there was a presentation and an endorsement of the agreement related to CCRS or -- the agreement -- or the authority to enter into an agreement with Mitchell rely -- regarding CCRS back in February of 2017.

From our clients' perspective, there were significant warnings in the public domain, as well as in the bo -- in the briefings prior to important significant expenditures related to this project. And I'm speaking in terms of CCRS. There was an additional 3.4 million spent in '16/'17 and 5 million in '17/'18.

Finally, in this subject area, our clients note the observation from the Gartner Group benchmarking report that there is a need to improve business process management, to improve the efficiency and effectiveness both of I -- information technology and of Manitoba Public Insurance generally.

In terms of this error -- error -- area, at slide 98, our client makes the following recommendations in terms of findings.

First, that there was a failure to adhere to standard could business practices in the development and evolution of the PDR business case.

Secondly, and as a consequence, the CCRS was a failed project and PDR is best characterized as a deep negative project, with a significant negative net present value.

Third, that the eighty-one dollar ($81) premium for the 2018/'19 year payable to the repair industry is not consistent with industry standard and you can stroke out the words "and is inconsistent" at the end of the third bullet.

Fourth, that the quality of the NPV analysis presented to the Board by MPI and by the Gartner Group was not consistent with the expectations of the Board.

And from our clients' perspective, this is something we would recommend when you -- you hear our recommendations for -- for other utilities or Crown monopolies appearing before this Board and relying upon expert evidence, external evidence, it would be useful and helpful to have a notification or indication from these external witnesses whether their analysis is consistent with good practice in all regards.

External experts retained by these corporations, it's a challenging role. They have a business relationship. They want to maintain that business relationship but no doubt they want to assist the Board.

And from our clients' perspectives, heightening the expectations for these external advisors will be well recommended.

It also is important to note that in the last year to year and a half to two (2) years in terms of the value management process that Manitoba Public Insurance has taken a number of steps to introduce standard good business practices. Whether we'll see the application of those practices over the years, and certainly next year when we get to the legacy investments, but -- those steps should be acknowledged.

The last lengthy section of our analysis relates to the -- issues relating to the Rate Stabilization Reserve and the Capital Maintenance Program, and it's really assessing the reasonable revenue needs of an applicant in the course of its overall general health.

And it won't surprise you to know that our client really admires Mr. Viola, and they think it's his expli -- explanation of his beliefs is often useful. Our clients' analysis as we approach the issues under this topic is informed by client beliefs.

And belief Number 1 is that this Corporation is strong. It's got a legal monopoly on the Basic side, a de facto or -- or practical monopoly on the Extension side. In the event it has concerns about material adverse developments in the marketplace, it has ready access to members of the legislature given its Crown status. This Corporation has significant reserves in Basic and its reserves are significantly over target in Extension and SRE and one needs only to look at the quarterly reports or the annual reports to get a sense of the magnitude of those excess reserves.

And while in the context of this hearing we tend to focus on the Basic program, from a ratepayer perspective Basic and Extension are intimately connected and the health of Basic and Extension is intimately connected. And Mr. Graham the CEO for MPI at the bottom of page 100 makes that point himself when he highlights the market dominance of MPI in terms of Extension and relates it to its connection to the Basic program.

Belief Number 2 of our clients is that another Manitoba Public Insurance advantage is vigourous independent regulation. We have regular evidence-based hearings, which offer annually self-correcting mechanisms for the overall revenue requirement. Unlike Saskatchewan, they're regular and as the Board can take judicial notice of with regard to British Columbia, they are less politicized by government directives as they flow from -- in British Columbia.

This regular evidence-based mechanism is not only self-correcting at the revenue level, it also is self-correcting in terms of the relationship between classes of vehicle owners and between individual drivers and individual vehicles.

There is dislocation annually because

of driver safety rating and the CLEAR, C-L-E-A-R, assessment of vehicle risk, but that also is -- from our client's perspective, evidence-based and gives the Board and this process and MPI a defensible position for consumer volatility concerns to be able to argue that they're based upon risk; either the risk we bring to the system because of our driving behaviour or the risk that our vehicles bring to the system.

Our client believes a third essential element of this vigourous independent regulatory process is the dynamic -- use of the Dynamic Capital Adequacy Testing to set the Basic Rate Stabilization Reserve, based upon Manitoba data, based upon Board directed risk tolerances and responsive to Manitoba risks. And this Board's well-known aversion to rewarding bad management decisions is also an advantage from our client's perspective.

Our client believes strongly that ratesetting stays healthy when government stays out of ratesetting and our client, to be frank, was uncomfortable with the messaging that appeared to be sent by Manitoba Public Insurance on the first day of the hearing about the government's wishes.

They were relieved on October 23rd when the CEO of Manitoba Public Insurance confirmed that there had never been a discussion in relation to rates and what those rates should be.

But our client is appreciative of the direction from government to respect the independence of as set out in the many layers of these organizations and of these -- and of the PUB itself.

A driving element of our clients' submissions in this subject area is their belief that a well cushioned Crown monopoly is bad for efficiency. And in one (1) more slide, I'm going to talk to you about the erra -- the era of over-collection from ratepayers.

But from our clients' perspective, many of the challenges Manitoba Public Insurance experienced in the early 2010s stem from the fact that it was a very comfortable Corporation and some of those challenges are reflected in the absence of financial models. Can you imagine back in 2010, a modern Crown Corporation unbee -- being unable to model investment -- our interest rate risk?

Some of the symptoms were the profound asset liability duration mismatch in the early 2010s, a two (2) year tolerated mismatch. Some of the Corporation's struggles in terms of responding to the great recession, our client attribute to that comfort and certainly our client suggests that the ill-managed BI3 and PDR initiatives are byproducts of the over-collection era, as were the absence of standard value management protocols. Imagine not introducing that value management proposition until 2017.

On slide 104, Manitoba Public Insurance has been quite forceful in talking about the challenges it experienced in the years since 2012/'13 certainly between 2012/'13 and 2016/'17, and certainly the -- the Board knows our clients' position that many of those challenges were of its own making.

We certainly see the recovery in '17/'18 but it's notable if you go back to '04/'05 and look at 2010 to 2011, the over-collection era. And in this hearing you heard Mr. Johnston talk about that '15 to '16 year period and when -- in which there was only one (1) rate increase.

And there's a reason for that. It's because Manitoba Public Insurance was over-collecting from Manitoba ratepayers and that over-collection, you look at the net income for '04/'05 fifty-nine (59). The next year eighty-five (85); '07/'08 sixty-nine (69); '09/'10 eighty-seven (87). Then you see the results for 2010/'11, when there was a massive relief of over conservative reserves with -- with -- of

283,000 thousand -- 283 million, I mis-spoke.

While Manitoba Public Insurance may have been very comfortable during this era, and you certainly heard Mr. Johnston yearning for it, the concerns -- the symptoms our clients' flagged at Slide 103, from our clients' perspective, many of those concerns stemmed from this lack of -- from this comfort. The lack of -- of agility, the lack of good business processes were encouraged by the ongoing over-collection from ratepayers.

There's been a lot of talk in this hearing about volatility, but not a lot of definition. Our clients will suggest to you that from a ratepayer perspective, volatility is what they see in their bill from year to year, hence, the three hundred thousand (300,000) vehicles this year experiencing rate shock.

The MPI perspective seems more focused on the optics of an overall average rate increase, and certainly our client submits that's -- that's why they conflate issues of rate increases to rebuild reserves and real issues of rate shock. And at least as Mr. Graham expressed to me, the government concerns a volatility that he talked about so much during the -- the first day of the hearing were the annual results -- the -- the accounting results of the -- of the

Utility.

From our clients' perspective, our client believes that rate stability is important, but in the context of Manitoba Public Insurance, it's inescapable and our client believes that the best response to volatility is good management.

Volatility in terms of individual rates is a natural result of CLEAR and the DSR adjustments. As long as we want consumers to be paying a rate that -- that res -- res -- reflects the relative risk, there's going to be that volatility in the bills that consumers expe -- experience. We look to cap it because that's very dangerous and difficult for many consumers excessive stability, but it is a reality of how we set rates.

Our client strongly believes that an over-collection of rates from present-day consumers to dampen or avoid volatility will be unsuccessful and is not an appropriate response and that good management practice, good forecasting, is the best answer to volatility.

We're going to turn more directly to the Rate Stabilization Reserve. And again, our clients want to -- wish to remind Manitoba Public Insurance that the Rate Stabilization Reserve was never intended to prevent rate change. Coming out of the Klopstein Commission, coming out of the overt politicization of Manitoba Public Insurance, the 1980s, coming over the real rate shock out of that time, that RSR is there. It was intended to prevent rate shock, not rate volatility.

And in terms of teske -- testing the risks that ratepayers face, not in terms of insolvency, not in terms of volatility, but in terms of preventing rate shock, we have been engaged as Dr. Simpson pointed out in a more than a decade-long conversation about how do we best estimate that risk with the purpose of avoiding rate shock?

And there's been a fabulous collaborative exercise built upon the -- the DCAT addressing issues of our -- what are plausible scenarios? What are our risk tolerances? And the Board has directed our clients and MPI that the appropriate risk tolerance is that 1:40 year standard?

So imagine our clients' puzzlement after the Board, which has expressly rejected the MCT previously, after the collaborative effort to develop the DCAT and to link it to the real risks faced by Manitoba ratepayers in terms of rate shock that the Capital Maintenance Provision in this proceeding is expressly tied to an MCT, a formulaic MCT calculation, 70 percent MCT.

And Mr. Johnston confirmed that the Capital Maintenance Provision is not linked to the DCAT, it's linked exclusively to the MCT.

And from our clients' perspective that MCT calculation is not appropriate for the purposes of the RSR, and it is not appropriate for any CMP. It addresses a different problem for a different marketplace. It's about insolvency tests. It's about the real reality that in the private sector in a competitive marketplace, if there is a massive call to increase rates for a firm, consumers are going to leave that firm and put its solvency into question and that insolvency, or that insolvency risk, can bring real risk to the entire economy.

So that MCT calculation, given those solvency concerns, addresses issues that our clients' question should be part of the considerations for the Rate Stabilization Reserve. Given the insolvency concern, it -- it ensh -- it shields imprudent behaviour such as operational risks which are cont -- controllable with good management.

Given that solvency concern, it sets a very different risk tolerance. If you think of the

DCAT, the Dynamic Capital Adequacy Testing analysis, it's focused on 1:40 year events over a time horizon, really between two (2)years and four (4) years. Look at what OSFI has elected with re -- regard to the MCT, conditional tale expectation or CT of 99 percent over a one (1) year time horizon, very different risk tolerances.

And the MCT as compared to the Dynamic Capital Adequacy Testing does not dynamically respond to evolving Manitoba risks or provide insight into the evolutions of those risks.

Slide 111 highlights the co -- the comments by Dr. Simpson in terms of why this Board rejected the MCT. Again that linked to insolvency in a competitive industry, and that it does not address the specific risks faced by MPI to this extent, it doesn't itemize and evaluate them in the dyna -- dynamic evolutionary way that the DCAT has done.

Ms. Sherry chimes in describing the MCT as formulaic with risk margins set to ensure private companies don't go insolvent, not tailored, not synchronized to a monopoly Crown corporation.

And as Dr. Simpson goes on to conclude and to ask: What is a 35 or 85 percent MCT mean? What does that tell us about the specific risks, the associated risk tolerance levels? What does that mean?

On slide 114, we've included an insert from the Office of the Superintendent of Financial Institutions, discussed with Mr. Johnston at page 679 of the -- the transcript.

Part of that MCT calculation is about operational risk and how is that defined?

"The risk of a loss resulting from inadequate or failed internal processes, people and system or from external events."

And at slide 680, we went through a conversation with them at -- at the magnitude of that operational risk calculation and the MCT calculation.

It's not insignificant. In the years that we looked at, it was between 64.6 million and 77.3 million. Less Mr. Johnston chastise me, I will -- will note that he said you would have to divide that by 1.5 to see how it actually figures out on the bottom calculation, but that's still a big number, a big shield, to shield inadequate or failed internal processes.

And in the context of a solvency calculation that is a perfectly reasonable calculation. But that's not with the DCAT is about. That's not what the RSR is about. It's about rate shock.

Being a little puzzled by this shield for incompetence found in the -- in the MCT, we put Mr. Johnston at page 682 and 683 of the transcript. As the MCT contemplates it, operational risk is associated with the failed information technology project, would that be contemplated?

No, Mr. Johnston, to my surprise didn't have the entire document at his fingertips, but he said:

> "But my understanding is it would be for things like that or of that nature."

He candidly admitted that. Given this shield in the MCT for bad management, our client cannot reconcile that with the state -- and given the link between the Capital Maintenance Provision and the MCT, our client cannot reconcile that reality with these statements by Manitoba Public Insurance saying that the RSR should not go to funding bad choices.

The intent of the CMP is by no means to take away the accountability or the responsibility of management, Mr. Giesbrecht suggests, yet they select a calculation, a ratio that puts in a bad management shield. Mr. Johnston goes, If we did something that deteriorated our MCT ratio, it wouldn't be right to us ratepayers to -- to pay for that. Yet, failed information technology projects appear to be shielded by the operational risk calculation.

The PUB also chimed in on this way back -- well, both Mr. Oakes and I were here -- in terms of what the RSR should be intended to protect against. And going back to the old risk analysis that was being promoted by Manitoba Public Insurance in the time, the Board found both in '98 and '99 that operating expenses that were controllable were not properly part of the calculation of the risk analysis. It was inappropriate, as -- as these expenses were at least partially controllable by management, to use their words, and our client agrees.

There's been a lot said about how the MCT is objective. From our clients' perspective, that's lovely, but objectivity with limited relevance is of limited value. And this Board, in Order 59/'18, in the Hydro context, provided some really interesting insight into debt/equity analysis.

You could look at Manitoba Hydro, with its debt/equity ratio at a certain level, and compare it to a private company, which is at 50/50, or compare it to the well-managed Bonneville Power at a different ratio. And unless you dig deeper, what's the insight?

By themselves, these objective measures offer little insight unless we dig deeper. Telling us that BC has an MCT target of a hundred percent doesn't tell us much about the health of the Corporation, or whether it's ratepayers are vulnerable to rate shocks, i.e., have they been setting rates properly, or setting them politically?

And is there any evidence in this proceeding about the process by which the MCT targets in Saskatchewan, BC, and Quebec were adopted?

Were they evidence-based processes, such as before the PUB, or were there political processes and cabinet directives?

The evidence on this record is unclear. In Information Response CAC-2-20(b), CAC/MPI, our client, noting that one (1) of the described purposes of maintaining a certain capital level was to protect -- protect ratepayers from potential rate shock, thought it would put to the question, MPI, How do you define rate shock? And MPI doesn't have a definition.

And so from our clients' perspective, the credibility of the assertion that the CMP is intended to address rate shock is -- is curious, given that MPI has not taken the trouble to define it.

What we do know, based upon our conversation with Mr. Johnston, is presented at page 121 -- or Slide 121, is that a 2 percent rate increase, from the Corporation's perspective, does not equate with rate shock, and even a 2 percent RSR rebuilding fee does not equate to rate shock, in his view.

Yet a lot of the conversation about the Capital Maintenance Program was about avoiding volatile rebuilding fees. Our clients have gone through voli -- through rebuilding fees before. They didn't embrace them enthusiastically. But if faced with the choice between having a healthy RSR, and from time to time, having to have rebuilding fees, or from over-collecting, our clients know what that choice would be, and it would not be to over-collect.

Ms. Sherria -- Ms. Sherry argues, and -- and based upon her understanding of intergenerational equity, concludes that pre-collecting for the Capital Maintenance Program is inconsistent with intergenerational equity. And obliging consumers to pay today -- when the RSR is well within target range for some future cost, or pressures on the RSR that may or may not occur, in her view, is inconsistent with the principle of intergenerational equity, and that it would be better to have a rebuilding fee at a time frame, if necessary, where there is less separation from -- from those in which the event occurred.

The hypotheses of this Capital Maintenance Provision is that the MPI portfolio risk is ever increasing. Dr. Simpson, in our clients' view, successfully rebuffed that hypothesis by noting the many moving parts in terms of the risk profile of Manitoba Public Insurance, and -- and suggesting that that hypothesis has not been demonstrated, and our clients conclude -- concur.

The last point on the CMP our client wishes to make is regard to the Saskatchewan CMP. And our client does not consider that analogous. We have an evidence-based, DCAT-driven RSR selection process in Manitoba, and an annual, evidence-based, independent rate-setting process, where Manitoba Public Insurance, in the event that rates are inadequate, or if they can make the case that they need more capital, can come before this Board, and if they can make the case, this independent Board will meet the need.

The urgency and the necessity of the Saskatchewan CMP, to the extent that it was required, comes out of a very different context, where there aren't annual reviews. And Ms. Sherry makes this point eloquently at slide 124. And my -- our clients' understanding of the record is that Saskatchewan has not been back in for a rate increase, although there may be one (1) pending since that CMP was introduced back in 2014. And from our clients' con -- perspective, that raises a concern of over-collection.

Was that CMP so generous that the -- the Corporation did not need to come back in for four (4) years? We don't know the -- the facts, but that is a red flag for our client, and that brings back uncanny and unhealthy echoes of that era of over-collection that our clients, between 2004 and 2011/'12, that our clients do not wish to revisit.

Finally, I wish to speak about the quality of the CAC (Manitoba) witnesses in this regard. Dr. Simpson and Ms. Sherry brought an interdisciplinary approach, the insight of the actuarial sciences and of Ms. Sherry's practical, lived experience in the insur -- property and casualty world, and then applied micro-economics and econometrics from Dr. Sim -- Simpson, as well as the experience of Dr. Simpson with risk analysis with other regulated industries.

On point 3, we note Ms. Sherry's extensive and senior experience, both with Crown monopolies, as you saw her role with SGI and MPI, and also with firms that are not shielded from the marketplace, like Wawanesa, firms that actually have to face insolvency and consumer risk, and that is an important insight that our clients believe is valuable to this perspective.

Ms. Sherry also brings actuarial experience, not just in Manitoba, not just in Canada, but with the broader North American marketplace and with private-sector property and casualty firms that are bigger than MPI. And in our clients' submission, significant weight should be given to their findings.

Ultimately, our client recommends with regard to the overall health of the Corporation, a finding that a shield for bad management is not appropriate for the RSR, that given the purposes of the RSR, the MCT analysis should not be linked to any determination of rates associated with the RSR, a finding that the CMP cushion developed for Saskatchewan was developed in a very different context for a very different regulatory process, and that the goals of efficiency and intergenerational equity are better served by rejecting the CMP cushion.

Just in terms of the allocation of costs between classes, our clients note the headline on slide 80 -- 128 speaks of the DSR review and dramatic disruption. This is not a -- a fear of the DSR review, but just to highlighting the fact that if the resi -- residual risk model and the logic of it is adopted, in the words of Mr. Johnston in the second bullet, that could mean some pretty dramatic changes to the model, and on the third bullet, where he agreed that the need for a vehicle premium percentage discount would likely be dramatically reduced under the hypothesis that the residual risk model was brought forward.

This is not an issue to be fearful of or concerned about. Our clients just note this is a very significant issue on the horizon as we seek to make rates increasingly actuarially indicated. And that highlights the need for engagement, espec -- both with stakeholders and consumers.

Speaking of engagement with consumers, slide 131, in this discussion, our client wants to separate engagement with stakeholders, like our clients, versus stakeholders with folks on the streets, the good folks of North Kildonan, where I live. While there is room for improvement, as it relates to stakeholders, the rate-setting process and accompanying technical conferences are an important part of accountability and good practice engagement. What is missing, in our clients' submissions, in Manitoba, is ratepayer engagement as well as stakeholder engagement outside of the -- prior to the rate application.

From our clients' perspective, engagement means more than an opinion poll. It means more than a fifteen (15) minute consumer presentation after that poor consumer has tried to make sense of the five thousand (5,000) page rate filing. And our client asked whether evolving good practices in other jurisdictions that we collectively could look to to better involve stakeholders, but -- at -- at least as importantly, to better involve consumers.

And a perfect example of this is what do consumers mean when they respond to MPI polling about stable rates? Is it their bill, which our clients suspect, or is it the overall average rate, or is it the net income? Our clients have our own hypothesis, but our clients observe that in our discussions with MPI, it indicated that while it has an ambitious examination of the customer experience, engaging with its ratepayers in terms of the rate-setting process and application is not a primary part of that application.

Our clients will cert -- simply point out that if Manitoba Public Insurance wishes advice on how to engage with ratepayers on issues related to rates, that advice is just a phone call away, from our clients or from others, and is certainly an integral element of how our clients prepare for these proceedings.

I'm going to turn it over to my colleague Ms. Dilay. Mr. Chair and members the panel, just one (1) point. We have two (2) confidential slides. We're not obviously going to talk about them online. Our clients -- I -- I think we're proposing -- the slides are well-prepared by my colleague, Ms. Dilay. They're fail -- fairly self-explanatory. Our client was contemplating that rather than kind of go offline, we could just submit those in writing to the Board on -- but that -- I guess there's three (3) slides, but that is up to the Board. I'm happy to speak to them.

THE CHAIRPERSON: I'd like Mr. Scarfone maybe to take a look at them. The problem is if that they're submitted and he wants to comment on them -- just -- let me just think this through. We -- we have a problem, because we're going to have it in confidence. Mr. Scarfone may want to comment in reply on them.

DR. BYRON WILLIAMS: Yeah.

THE CHAIRPERSON: So maybe what we'll --

DR. BYRON WILLIAMS: Okay.

THE CHAIRPERSON: -- we'll do -- I -- I'm trying to figure out whether we're going to conclude this morning, or if we're going to break, and -- and go this afternoon.

DR. BYRON WILLIAMS: So I can indicate on the public portion, we have about ten (10) minutes left.

THE CHAIRPERSON: No, I -- I appreciate -- I -- I can see that.

DR. BYRON WILLIAMS: And -- and I suspect only about six (6) minutes, if we go through the slides. And so we'll -- we'll just finish the public's portion, and then we'll be at the -- at the -- we'll respond to the will of the Board.

FINAL SUBMISSIONS BY MS. KATRINE DILAY:

MS. KATRINE DILAY: Thank you. So as Mr. Williams mentioned, I will be going through the recommendations of CAC (Manitoba). Mr. Williams has already pointed to a number of recommended finding, and so those will build -- our recommendations will build upon that.

The first recommendation is that the Public Utilities Board adopt a standard interest rate forecast, SIRF, or a 50/50 interest rate forecast. Our clients' submission is that that issue was settled by the Public Utilities Board last year in the 2018 GRA, and was supplemented by expert evidence in the year, the 2019 GRA.

In terms of our clients' recommendation for the recommended range for the rate stabilization reserve -- sorry for the -- the typo, there -- they would recommend a range of 122 million to 250 million, and those numbers can be found in Exhibit MPI-26, figure 7, if we look at the PUB-approved methodology using the 50/50 interest rate forecast.

Our clients' recommendations regarding the ALM study, or the Asset Liability Management study. The MPI Board should be asked to revise the current ALM study in light of Mr. Viola's eight (8) recommendations to this Public Utilities Board. If

MPI chooses not to revise the current ALM study, our clients would propose, on a forward-looking basis, a 0.5 percent annual reduction in rates until such time as MPI can establish a selected investment portfolio in a reasonable and prudent matter (sic). And we note that the 0.5 percent does not reflect the opportunity cost at comparable risk in the evidence presented before this Board.

Thirdly, with regards to the ALM study, our clients recommend that further external experts retained by MPI who are testifying before the Public Utilities Board should be directed to identify whether, in their professional judgment, the methodology used is consistent with professional best practice.

Our clients' recommendation regarding the Capital Maintenance Provision is that it be rejected. In our clients' view, the CMP provides an appropriate cushion for a monopoly Crown corporation, which is inconsistent with prior regulatory direction. The MCT, or the Minimum Capital Test is expressly linked in part to a formulaic allocation that is solvency measure, to hold management accountable, and to protect consumers, in the context of private P&C companies.

The CMP would effectively allow the MCT, the Minimum Capital Test, to replace the DCAT as the primary driver of rates relating to capital reserves, notwithstanding the express direction of the -- sorry, the express rejection of the MCT by the Public Utilities Board.

Our clients note that for the 2019/2020 fiscal year, total equity is forecasted to be above the RSR range, which our client propose to be based on PUB-approved -- approved methodology, and a 50/50 interest rate forecast if we consider a zero percent rate increase, and we would direct your attention to pro forma 10. With a zero percent rate increase, total equity is projected to be $257 million.

Our clients' recommendations regarding complex claims is that MPI provide an update for the gen -- the next General Rate Application on steps to improve the handling, including adjudicating, reserving, and managing the return to health process of complex PIPP claims, and the status of complex PIPP claims, as measured against pre-BI3 benchmarks, or existing benchmarks.

Our clients also recommend that MPI provide the PIPP claim benchmarking framework relating to complex claims discussed at transcript pages 865 to

866 as part of its next GRA filing.

Our clients' recommendation regarding information technology is that, given material challenges with the implementation of major IT programs, including BI3 and PDR, as well as ongoing effects on ratepayers, MPI be directed to report to a technical conference on the business case for legacy IT systems, in other words, AOL, CARS, and including the interfaces to other systems, to the renewal of those legacy IT systems prior to the next GRA filing. The legacy IT systems renewal business case should include examples of net present value analysis demonstrating adherence to good business practice.

On slide 140, our clients recommend that MPI be directed to report back to the PUB on efforts to bring IT staffing budgets in line with peers. So we would recommend adding the words "IT staffing budgets."

Our clients' recommendation regarding the driver safety rating, or DSR, is that given the potential dramatic changes to DSR which could result from the residual risk approach, MPI should be directed to engage with stakeholders, including CAC Manitoba, CMMG, CAA, and Bike Winnipeg regarding best practices for consumer engagement, as well as their recommendations and views on the DSR.

The recommendation regarding experts, which Mr. Williams alluded to in his presentation. In the future, any external expert retained by MPI and providing evidence to the Public Utilities Board should be directed to expressly identify any aspect of their evidence that does not conform with best practice.

On slide 141, our clients recommend -- certain -- make certain recommendations, pardon me, regarding engagement with consumers. Prior to the next GRA, MPI should be directed to consult with stakeholders, including CAC (Manitoba), and CMMG, who are both active Intervenors in this proceeding, on potential tools to better engage ratepayers outside of the formal hearing process. In other words, such as focus groups on pricing issues such as stable rates.

Our clients note that good practice consumer engagement includes engagement before, such as when an issue arises, during, by that we mean that ideas are put to consumers on how to resolve the issues, as well as after, when feedback is sought on how the solution is performing. Consumer and stakeholder input should be recorded, and where ideas are not or cannot be used, explanations of why not should be made publicly available for accountability and transparency purposes.

Our clients would also recommend that budget approvals for Intervenors could contemplate costs for public engagement presented to the Public Utilities Board as evidence.

And our clients' last recommendation, on slide 142, relates to the recommended rate in this proceeding. Our clients recommend a rate decrease of 1.75 percent. And for their calculation of this recommendation, we would direct your attention to Exhibit MPI-26, and specifically, figure 3. That figure shows the break-even rate indication using a 50/50 interest rate forecast, and including the RSR investment income, would be negative 1.75 percent.

We note that this recommended rate in -- takes into account the rejection of the Capital Maintenance Provision, the use of the Standard Interest Rate Forecast, or the 50/50 interest rate forecast, as well as the inclusion of the RSR investment income.

Our clients also note that a further rate reduction, on a forward-looking basis, could be ordered based on foregone investment opportunities. And on a forward-looking basis, we mean for -- for future years, as we noted in our recommendation for -- regarding the Asset Liability Management study.

Now, subject to any questions, that would be the conclusion of CAC (Manitoba)'s closing submissions on the public record. Thank you.

THE CHAIRPERSON: Thank you. In terms of the CSI, I think that we're prepared to take the document, but subject to Mr. Scarfone reviewing it -- and if Mr. Scarfone wishes reply, then we're going to have to go with the CSI, and we'll have the document put in as CSI, Mr. Scarfone's comments in reply at that point. So I'd leave it to him.

I'm going to put him on a tough spot. Mr. Scarfone, I guess the question is, how you want -- I don't know if you've had an opportunity to review it, and can take a position on it right now. I don't know how long your reply will be.

I just want to remind you the reply is intended for any new issues raised in their submission that were not covered in your submission, or were sort of brought forward for the first time. And so that should be the focus of it. So I don't know how long your reply would be.

So I'm going to put you on the spot right now, and -- and ask you. And I guess the question is whether you're prepared to proceed now, or whether you would want a -- a break.

MR. STEVE SCARFONE: Well, I have a couple comments with respect -- with respect to that, Mr. Chair. So first -- firstly and foremost, looking at the hour, it's -- it's -- we're approaching lunch, so that is a factor to consider.

The second is, I haven't had a full opportunity to review the proposed material on the CSI front.

And -- and lastly, and probably more importantly than the others, is I have some colleagues that are working diligently on some arguments, or some reply points that the Corporation would like to make, and so I would -- I would probably want to confer with Mr. Guerra, my co-counsel, and perhaps Mr. Crozier, my client, to discuss what we'd like to say in reply.

But having noted your comment, I would like to ask if the Corporation could have some latitude when making its reply on the -- in the area of investments. And the reason I say that is because when, as I indicated yesterday -- and we won't take too much liberty, but when preparing our closing, we were doing so well, there was still evidence being given by Mr. Viola. And so there -- there would be, I expect, some areas that might not be new in our reply, but that's -- that's obviously in the Board's discretion.

THE CHAIRPERSON: But the -- the problem -- the problem is reply is not intended to simply repeat arguments --

MR. STEVE SCARFONE: No --

THE CHAIRPERSON: -- in your submission.

MR. STEVE SCARFONE: -- and -- and that's not what --

THE CHAIRPERSON: If you have additional arguments raised as a result of their submission --

MR. STEVE SCARFONE: Yes.

THE CHAIRPERSON: -- that's appropriate. But the panel doesn't want to hear the same arguments again simply reinforcing -- reinforcing previous arguments. And that -- I -- and I just put it to you because if that -- if that starts happening, I tend to lend -- let a little leeway, but as -- as you probably have discovered, there's a line, and when you cross the line --

MR. STEVE SCARFONE: I'll hear from you.

THE CHAIRPERSON: Yeah. You will.

MR. STEVE SCARFONE: Yes.

THE CHAIRPERSON: The -- the other thing, as well, is I want to give the panel an opportunity to ask questions in relation to your submission. There may be some questions.

So we're going -- is -- I -- I want to be fair in this. An hour would be sufficient, Mr. Scarfone?

MR. STEVE SCARFONE: Yeah, I think so. Yes.

THE CHAIRPERSON: Okay, so we'll adjourn for an hour.

MR. STEVE SCARFONE: Yeah. Thank you.

THE CHAIRPERSON: Mr. Williams, you have a quizzical look on your face.

DR. BYRON WILLIAMS: Only -- I'm just wondering where I'm going to move to if -- if there are any questions for us. Well, I guess we'll sit here. We'll find out when we come back at 1:00.

THE CHAIRPERSON: Well, quite frankly, in -- give -- given the -- the demand for seats here now, I don't think it really matters. So we'll adjourn until 1:00. Thank you.

DR. BYRON WILLIAMS: I'll move.

--- Upon recessing at 12:02 p.m.
--- Upon resuming at 1:03 p.m.

THE CHAIRPERSON: Before we go to reply, I'll ask the panel if they have any questions.

BOARD MEMBER HAMILTON: Thank you, Mr. Williams. I have one (1) question in relation to the recommendations that were made in the last few pages of your submission. I note that there's nothing specific in relation to the position of CAC related to the asset mix in the Basic portfolio, and I wondered whether the references to the ALM study cover that off in terms of what your recommendations for our findings are?

DR. BYRON WILLIAMS: We didn't make recommendations on that in -- in the sense that at least our understanding of the regulatory process is that the role -- the role of -- of the Board is to determine the rates that flow from the -- the Application.

If we were -- rather than to direct MPI in terms of the actual composition of its -- of its portfolio, if -- if from our clients' perspective, Mr. Viola tried to address that when he was talking about the -- at a general level, he made the point that while MPI has concentrated its risk in this portfolio, it could diversify the risk by having some composition of real return bonds and with the portfolio diversifying its risks through real equities -- sorry, through equities and other real assets, but we didn't have a specific recommendation.

Our -- our observation was that the MPI application was unreasonable and imprudent and -- and we thought that should, if MPI chose it -- chooses to persist in it, then that should be reflected in rates. So I'm not sure if I'm helping you or not Board member.

BOARD MEMBER HAMILTON: Yeah. Thank you, Mr. Williams.

THE CHAIRPERSON: Kristen, could you pull up page 25 of the CAC presentation?

Mr. Williams, the first paragraph for the last two (2) years SIRF has clearly outperformed the naive forecast. Is that correct? I mean, I know the last year, but for the last two (2) years?

DR. BYRON WILLIAMS: I'd have to look at Dr. Simpson's -- this is his statement. But I think if -- I -- I don't have his PowerPoint right with me, but I -- I think he looked at the results from two (2) different years. We could look that up, Mr. Chair, while you're...

THE CHAIRPERSON: Okay.

DR. BYRON WILLIAMS: But I -- I believe that was presented in his PowerPoint. Yeah and I'm -- I'm quite confident that was his conclusion.

THE CHAIRPERSON: Okay. We heard evidence that I guess the concern of the -- of -- of CAC is that if interest rates go up, and we have a naive forecast, MPI will receive too much money.

Is that correct?

DR. BYRON WILLIAMS: All other things being equal.

THE CHAIRPERSON: Okay. And what happens in a situation where the -- there's a projection for SIRF but, in fact, interest rates haven't gone up?

DR. BYRON WILLIAMS: And that -- that experience has happened. In -- in that case, the -- the results would be, all other things being equal, lower revenues than MPI -- or lower net income than MPI would expect.

That's why collectively we're trying to come up with a best estimate. The information suggests that the SIRF is the best performing given the material change in circumstances.

If you note our clients' recommendations, the rates that flow out of them are based on a 50/50. That's that element of caution that Dr. Simpson endorsed last year. And -- and if you look at the rate numbers --

THE CHAIRPERSON: Correct.

DR. BYRON WILLIAMS: -- that's what our client has done.

THE CHAIRPERSON: Because interest rates are going up?

DR. BYRON WILLIAMS: Yes and there's -- interest rates are going up, but it's not just that they're going up, it's that the fundamentals that would tend to drive interest rates are -- are going up as well in terms of the capot -- capacity of the economy.

THE CHAIRPERSON: Okay.

DR. BYRON WILLIAMS: And, sir --

THE CHAIRPERSON: Yes.

DR. BYRON WILLIAMS: CAC-26, Slide 12, shows where Dr. Sim -- Simpson drew those conclusions from.

THE CHAIRPERSON: Okay. Thank you.

Two (2) years ago we were here and we had flat interest rates and I had a series of economists appear before the Board, indicating that we should be moving forward with -- with SIRF. MPI's position was it should be 50/50 and interest rates were flat.

Kristen, can you pull up CAC-27? I believe this is the position of CAC two (2) years ago that 50/50 was -- should be rejected at a time that interest rates were -- had been flat for eight (8) years. I -- I guess the concern I have is we're -- and -- and I'd like your comment.

We're trying to put precision in an area where there seems to be nothing more than imprecision. I just remember somebody being interviewed and asked what it could -- in -- interest rates were going to be a year from now. An economist and he -- he said if I knew what interest rates were going to be a year from now, I wouldn't be doing this, I'd be putting my money in -- into the market and making millions of dollars.

I'm just wondering if we're trying to, you know, fore -- you know, forecast something based on something that changes so quickly.

DR. BYRON WILLIAMS: Everything's a forecast, sir, whether you go naive, 50/50 or the

Standard Interest Rate Forecasts. So if you think of the advice of Mercers, which is definitely not to do -- to do naive or otherwise, it's all a -- we're not -- you have -- you can't abdicate your responsibility there. There has to be a choice made, we would submit.

The position in -- our client amended its position last year and tried to inject some caution into its position and it's maintaining that caution, even though events are suggesting that the Standard Interest Rate Forecast is probably the best going ahead. It's not like we don't have insights, sir, in terms of the market fundamentals and the five (5) changes in the overwrite -- overnight changes or the language of the bank.

So, it would be quite justifiable from our clients' perspective to pick the Standard Interest Rate Forecast, but out of some caution and in recognition of the challenges, that's why the numbers that flowed out of our clients' recommendations are based on 50/50.

And so I don't know -- our client ha -- has been struggling with these issues as well. Two (2) years ago we took the standard. Th -- last year, certainly, Dr. Simpson was the 50/50 and our client said that was acceptable and this year, even though the evidence tends to suggest that the standard would be the better result, given the material change in circumstances, our client in terms of the rate numbers is picking 50/50. That to us is appropriately cautious. That's trying to balance the risk of under estimation with -- with the real risk that we're -- that we're going to over collect from ratepayers.

THE CHAIRPERSON: Thank you. I believe Ms. Sherry said that one (1) of the reasons we don't need a Capital Maintenance Provision is that because unlike Saskatchewan where -- where they do not have rate hearings, we'll be back here in a year. And if we need a rate rebuilding fee, we can deal with it at that point.

Am I correct in that being her position?

DR. BYRON WILLIAMS: Within -- within a broader context of, we already have a process to set an appropriate range of targets and that the financial dynamics due change. Yes, I -- I think that is one (1) of the points she made.

And she argued that -- that you would be rather than over collecting when you're in --within your target range, it would be better from a temporal context to be close -- more closely related to the event but, yes.

THE CHAIRPERSON: So -- so if we under collect in a -- if we under collect for a year, we're not in that difficult situation because one (1) year later we'll have a -- we'll have a rate hearing and either introduce a rebuilding fee or introduce higher rates?

DR. BYRON WILLIAMS: Yeah. Although, like, there's natural variants, sir, in the results right? It -- it's an inherently risky business. If you're within your target range for reserves and in this one, toward healthily within your target range, why would one put an extra surcharge on to -- to collect when you're in that state?

We -- we are already pre-collecting from ratepayers through Basic and Extension, to some degree, why would one add a surcharge on -- on a -- on a -- on a reserve? It's what are our clients struggle with.

THE CHAIRPERSON: Believe me, the panel struggles with it -- it every year on the -- we're hearing the same issues every year. And -- and we struggle with it every year.

The problem I have is -- I -- I just

wonder if the same issues cut both ways. You know, if you're reviewing everything every year, do you make the adjustments every year, up and down, or do you -- do you lean one (1) way and then -- and then make the adjustment only in one (1) direction at the hearing? I can see everybody's confused with it.

So, Ms. Sherry's position is, it's better to lean towards having a lower rate and bringing a rebuilding fee. So I put it to her, so if you did it once every three (3) or four (4) years, you would -- would you see it as a normal -- a normal thing and I believe she said yes.

So it -- it would be better to be under and have rebuilding fees than potentially having too much and re-adjusting the following year.

DR. BYRON WILLIAMS: This is how our clients would see it. Just so -- let's -- our clients would say that you should be setting rates based upon actuary -- like future rates based upon expected future costs.

In the context when your reserves are already well within target, there's no need to build into the reserves at a -- a fund to over build the reserves. That's -- that's it is -- is simplest as we can say it.

Like -- if -- if we come back next year and MPI's at 110 million, then -- then your expected future costs would include the rate indication, plus a reserve rebuilding fee.

From our clients; perspective looking at actuarially indicated rates, the appropriate rate is the -- the future rates. There is no need to rebuild the reserves. We're in -- we're within target and healthily within target.

THE CHAIRPERSON: Okay.

DR. BYRON WILLIAMS: That's the perspective, I think.

THE CHAIRPERSON: Thank you. Final question. You raised the issue of inter-generational equity and you raise the issue of Manitoba Hydro. I think you talked about Manitoba Hydro and how there had been an argument of inter-generational equity.

DR. BYRON WILLIAMS: I -- I think in the context of Manitoba Hydro, I was actually make a different point.

THE CHAIRPERSON: Okay.

DR. BYRON WILLIAMS: If I -- what I was trying to say is the insight we had from the Hydro hearing is -- is that there's very little insight at looking at debt/equity targets in isolation unless you drilled down into the realities of the Corporation. So a company that looks like it's got 80/20 versus 75/25, those fundamentals may be very different. So, that's the point I was trying to make.

THE CHAIRPERSON: I see. Okay. Thank you very much. Thank you, Mr. Williams.

Mr. Scarfone ...?

DR. BYRON WILLIAMS: Mr. -- Mr. Chair...?

THE CHAIRPERSON: Sure, Mr. Williams.

DR. BYRON WILLIAMS: I apologize. I do have to -- I've got a class I've gotta teach so --

THE CHAIRPERSON: Go teach 'em, Mr. Williams. Thank you very much.

REPLY BY MR. STEVE SCARFONE:

MR. STEVE SCARFONE: Thank you, Mr. Williams. Thank you, Mr. Chair.

So the Corporation has some comments in reply. I do believe, Ms. Schubert -- yes, thank you, Kristen. We expect if -- if the panel will oblige the Corporation to be about fifteen (15) minutes in its reply this afternoon, generally speaking, and I'm aware of the Board's concerns about the purpose of reply submissions.

I can say perhaps to shortcut some of these, that we have replied to some direct argument that we heard, but generally speaking, I think it's important that the Board remember to review the evidence in all its context when relying and reviewing the submissions of the Intervenors. And so I say that.

I'll give just one (1) example. I won't deal too much with Mr. Oakes's defence, or his closing argument yesterday. You know well, Mr. Oakes is entertaining, and uses colourful language. We do take us some exception with what he said, and some of it, with respect, is taken out of context.

So for just one (1) example, and I appreciate the Board will review the evidence in this regard, you know, he brought to the Board's attention yesterday the fact that Mr. Johnston, the chief actuary, admitted that the CMP could really just be any number. That, you know, he admitted under cross-examination that that could just be 5 percent, and they could insert any number they wanted for the CMP.

What Mr. Oakes didn't to bring your attention to, or remind the Board of, was that on redirect, Mr. Johnston and said, Would it still be a CMP if it was 5 percent? And the answer to that, of course, was no, because the only number that can be supported for the CMP was the two point one (2.1).

So if -- yeah, management can say 5 percent, but it's no longer a CMP. It's now a two (2) per -- 2.1 percent CMP, and a -- a 2.9 percent rebuilding fee, or surcharge, or whatever it was that Mr. Johnston said. So just be careful with some of the -- the evidence or the argument that you heard in that regard for Mr. Oakes, and we won't go any further on that.

And -- and the same applies, to some extent, on the -- on the argument you heard this morning. You know, Mr. Williams is more careful in this regard, and we appreciate that. But the stress tests on the ALM, this is an example of -- for -- for this purpose. The stress tests on the ALM were, in fact, done, and three (3) of them were produced by way of undertaking, including the inflation stress test.

And the tests, quite candidly in that response, were said to have been flawed in some respects, and weren't presented initially. But in the spirit of the Corporation's openness and transparency, the tests were produced. The easy answer to that undertaking would have been, The stress tests weren't done, or they weren't done, but no.

Mercer redid them, and we provided them to everyone involved to review, in the -- in the spirit of openness and transparency. So I just want to make those comments, to be careful with -- with the interpretation of some of the evidence, and some of the argument that the Board has heard.

On the first slide, Ms. Schubert, this deals, to a large extent, with some of the recommendations that the Intervenor CAC has been making, including, perhaps, for the Board's consideration, some technical conferences. The Board -- sorry, the Corporation just wants to reiterate that Mr. Williams has already claimed that this process is robust. But now they want to appear -- it appears that they want to expand the process to include additional technical conferences.

I would remind Mr. Chair and the panel members that there was a technical conference on the Capital Maintenance Provision. One (1) of the expert witnesses that were heard from that this hearing didn't show up for that technical conference, and so the Board should be mindful of the costs associated with expanding the process. The Corporation would like to move in the other direction in trying to streamline the process.

And -- and as it concerns the ratepayer engagement, we think that's what this process is for, is this is a public forum. The -- the Consumers' Association participates year after year, and they are granted standing on the grounds that they represent those consumers that Mr. Williams would have the Corporation now engage before the public hearing. And that, to us, again, as -- does not seem economical. That's what this process is for.

And reiterating there at the third bullet, particularly with this rate application, MPIC has opened its books. Under the new regime, there is an increased transparency, and we saw that this year in the form of a number of motions to have information that, in past years, would not have been shared. But we had confidential orders made whereby all the documents in the Corporation's possession on all information technology projects and other matters were shared with everyone involved. And we think that's the -- the correct way to do it, and that's the direction the Corporation is moving.

So again, on that -- on some of the recommendations, more processes is not the solution, in -- in our view. The -- the CAC proposes a tech con -- tech conference on legacy modernization. The

Corporation feels strongly that this is within the domain of management and the Board of Directors. Of course, the Board will be kept informed as it relates to revenue requirements and rate approvals, and that's no different than what's happened in years prior, what's happening this year, and what will happen next year. There will be full disclosure, full transparency, and openness on all spending associated with the proposed legacy modernization.

And on that front, you heard from Mr. Bunko, there's no -- there's been no decision made on that. There's been an assessment, and when that assessment is completed, it will be reviewed. A decision will be made.

And next slide, please, Ms. -- Ms. -- thank you. Mr. Williams implied that the IT department has mismanaged some projects. The only comments that the Corporation would to make in reply to that is at the time, as Mr. Bunko indicated in his evidence, certain assumptions remain relevant. The net present value of that project were current, and decisions were made when the new Gartner report was provided.

You've heard the evidence of the executive that mistakes will be made. The Corporation is no different than any other private corporations, but -- but the Corporation was here taking responsibility for the mistakes that have been made, and we're doing their best to prevent those mistakes from recurring.

Contradictions on the Asset Liability Management study. The Intervenor Consumer Associations of -- Group of Canada has no apparent objection to de-risking the portfolio and, as you heard yesterday, and I don't want to repeat what I've indicated already, a direct result of that was a reduction in the capital that was required, but they can't have it, in our view, both ways.

The -- Mr. Williams and his client reject the conclusion that the de-risking must be accomplished through lower risk investments, and they recommended, as a result, a -- a reduction -- an ongoing reduction for foregone investment opportunities. This, we say, is clearly at odds with the approval of the prudent costs in the regulatory context.

The Asset Liability Management study, in MPI's view, was eminently reasonable. Mercer did detailed work. They met with the investor. They conducted their due diligence, and they explored a suite of alternatives.

I might add that Mr. Williams, in his argument this morning, Mr. Chair, took aim at the nominal liability benchmark that MPIC and its Board of Directors preferred over the real liability benchmark. Comment with respect to that, Mr. Chair, is this: Of course, we all live in the real world. We live in a world where there is inflation. We live in a world where there's interest rate risk.

Having said that, why, then, would there exist a nominal liability benchmark? Why wouldn't every investor, given those facts of inflation and interest rate risk, go with the real liability benchmark? And that's a rhetorical question. I don't have the answer to that, but the industry seems to have presented two (2) benchmarks that investors can go with, and MPIC and its Board of Directors chose the nominal route.

And you heard Mr. Makarchuk indicate that that's not uncommon for investors to hedge inflation only partially, or perhaps maybe not -- not at all. That, again, was a decision made by the Board of Directors.

Mr. Viola -- and while we appreciate Mr. Viola's input and recommendations that we heard from him that this week, ultimately, the decision lies with the Corporation and its Board of Directors. And highlighting that point are some quotes from his testimony this week:

> "My background is not in insurance, but I understand the nature of the liabilities."

But when pressed on that, in cross, he said, "I'm not an expert on the liability side." And so we have here an expert from Toronto that is purporting to give advice on how MPIC and its Board of Directors have decided to invest the money. And I'm going to suggest to you, Mr. Chair, that Mr. Viola is no slouch; eminently qualified. Toronto, and even to some extent, Alberta, where Mr. -- Mr. Makarchuk comes from, two (2) vastly different economies than Manitoba. In fact, those two (2) are the most robust and strongest economies in the country. That's not Manitoba.

And what you have on the investment committee are Manitoba investment -- investment experts that have made decisions in the best interests of the Corporation and the Manitobans that pay the rates. And so we ask again that you give careful thought to that and defer to the expertise of the

Board of Directors.

Mr. Williams would have this Board substitute its opinion for that of the investment committee. There are a number reasonable outcomes that can be had with respect to any investment strategy, and this, we say, MPI's is as reasonable as any other. And lastly, MPIC's Board of -- of Directors has jurisdiction over investments, its clear mandate in the annual business plan.

Lastly on investments, and I -- I don't want to go too deeply into it, because we've canvassed much of this, but remember this. All of the criticism of -- of the investment strategy fall away if the inflation forecasts hold true. If inflation stays at 2 percent, around that level, all of these criticisms fall away.

And with all due respect to Mr. Williams, these issues, real return bonds, nominal versus real benchmark, inflation, interest rate risk, these, with respect -- and these are Mr. Williams's words -- these are not a significant gamble. And I don't want to undermine the importance of these issues, but it's -- it's much ado about nothing.

And the reason I say that is for two (2) reasons, Mr. Chair. Mr. Makarchuk said two (2) things: 1) that a sophisticated institutional client like MPIC should have an ALM study done every five (5) years, and 2) he said that the portfolio is sufficiently liquid to allow for a re-mixing, if necessary.

So if, for example, inflation started skyrocketing, there's nothing that would prevent the Corporation from engaging another firm to conduct an ALM study re-mixing its portfolio to protect it against rising inflation. We're not locked in to these -- to these matches that have occurred under the ALM.

And I agree with Mr. Williams that the Corporation isn't the master of its investments. Of course we're not a master. But I -- I'm going to speak to Mr. Graham after this and see if next year, we can retain Warren Buffett for some advice, because I would submit that there are no masters in this field.

The investment industry, generally speaking, is based on projections, forecasting, hedging, and predictions. It's far too speculative for anyone to suggest that someone should be a master in the field of investments. And so we go back to the question that I put the Board in my opening statement:

"Is the investment strategy that's adopted by MPIC a reasonable one? And if the answer to that question is yes, then it should be left alone."

On the net Capital Maintenance Provision, there's a couple of small points, here. Firstly, the Capital Maintenance Provision is not, as Mr. Williams suggested, used to prevent rate shock. That's not what it's for. That's the job of the Rate Stabilization Reserve. The Capital Maintenance Provision, as we indicated over and over, is to do one (1) thing. It's to maintain capital at the level it is from the start of the fiscal year to the end. That's it, so we don't have a depletion in capital.

And so that's a little strong, that first bullet, but I do agree that Ms. Sherry misunderstood parts of the application, the -- but the purpose of the CMP is unrelated to operational risk, and the -- the Minimum Capital Test is the appropriate measure for setting -- for setting the Capital Maintenance Provision.

The Minimum Capital Test does not in any way replace the Dynamic Capital Adequacy Test, not in any way. The -- the MCT comes in at the very end of the analysis, after Mr. Luke has performed his -- his adverse scenarios. Again, the Capital Maintenance Provision is not to prevent rate shock. We want to be clear on that.

The last bullet bears mentioning that MPI's approach is prudent fiscal management, and is consistent with industry best practice. Mr. Williams said, Well, let's look at the other jurisdictions. We have SGI, we have ICBC, we have Quebec, and MPIC repeats over and over again that these jurisdictions, not unlike ours, all have 100 percent MCT. And he says, Well, we don't know how they got there. How did they arrive there?

And we say, It doesn't matter. That is standard industry best practice. It doesn't matter how they got there. It -- it appears to us, at least, that this jurisdiction is the only undercapitalized public insurer in the country.

On rate shock, one (1) of the rec -- recommendations that Mr. Williams makes on rate shock is that if there's going to be any departure from best practices recommended by an expert, that those departures by MPIC should be brought to the attention of the Public Utilities Board in -- in the report. So, for example, Mercer would say, We'd like you to use our standard interest rate forecast, and MPIC says, No, you know what, we're going to do it on a curve.

And so Mr. Williams would have Mercer bring to your attention in its report MPIC's defiance, if you will, of its recommendation. That, we say, is completely inappropriate. What should happen instead, as happened this year, is the report is subject to a cross-examination, like in any proceeding.

Subject to a cross-examination, Mr. Williams can make his arguments, MPIC can make its arguments, and the Board decides on the weight that it needs to attribute to that particular issue, based on the evidence. So we don't agree that that's a -- a recommendation that has any application in this -- in this proceeding.

On rate shock, at first bullet, this is a General Rate Application, and why I say that is because it's a little unfair for Mr. Williams to cherry pick different passenger vehicle classes, versus motorcycles, versus trailers and say, Some of them are in excess of 5 percent, some of them might be between five (5) and ten (10). Some of them are under -- this is a General Rate Application.

The capping rules from the PUB have

been in place for years, and now they'd like this Board to take a look at what the individual pays, and we think that's entirely inappropriate in a general rate application. The ratepayers need to pay the cost of their insurance, and the premium should match the exposure.

I just want to -- before I read this conclusion slide, I just want to go through my own notes and make sure that I've canvassed everything that is properly put before the Board in reply, Mr. Chair.

(BRIEF PAUSE)

MR. STEVE SCARFONE: One (1) of the questions that Ms. McCandless put to Mr. Johnston was, What's changed from last year that led MPIC to adopt the use of the naive? The short end to that is nothing changed, because last year, MPIC was recommending that this Board make use of the naive forecast. We are again this year. Nothing changed.

We fully appreciate that the Board didn't accept MPIC's recommendation last year, ordered the 50/50. The Corporation felt it was compliant with that Order, but returned to what we feel is the best estimate, the naive forecast. So nothing has changed.

And so with respect to that, Mr. Williams said, Well, MPIC hasn't discharged its onus that naive should replace the SIRF, or the 50/50? What Mr. Williams conveniently ignores are the net income losses, the -- the money that the Corporation lost in making use of the wrong forecast, in my view, is a full answer to the onus. That should discharge the onus, $165 million in losses would discharge the onus.

Mr. Williams said with the current investment strategy, there are significant indexing risk in the MPIC portfolio. Those were his words, Significant indexing risk. There was no evidence -- no evidence that there's indexing risk. Indexing risk, as I understand it, is -- is attributable to rising inflation, then there would be indexing risk. No evidence that inflation is going up.

(BRIEF PAUSE)

MR. STEVE SCARFONE: And lastly, I -- just for my own selfish reasons, Mr. Williams said that I kept mixing up terminology yesterday. I just want to clarify, when I make use of the term 'the

Basic claims liability portfolio,' that's the name the Corporation gives its Basic claims portfolio.

I think what was throwing Mr. Viola was the word 'liability,' because he's like, You're on the wrong side of the sheet, whatever the accounting sheet was called. But we call it the Basic claims liability portfolio that contains the assets that match against the liabilities. So we've probably confused everybody here, but that's just the name that we give it, and -- and I've been trained in that regard, to call it the Basic claims liability portfolio. But for your purposes, Mr. Chair, it's just the Basic portfolio, the one that, you know, we've canvassed here repeatedly.

So in conclusion, MPIC has presented the facts and -- and evidence. That -- that's obvious, and -- but we do want to reiterate that this particular General Rate Application, Mr. Chair, has been one that's been open and transparent. And I don't think anybody could quarrel with us on that.

We may not have a fancy title to our closing argument about cushioning, and skimming premiums; that's not what this Corporation is about. And we say that this Board cannot ret -- reject the application on these trivial objections.

That concludes the Corporation's reply.

THE CHAIRPERSON: Thank you, Mr. Scarfone. This concludes the 2019 Manitoba Public Insurance Corporation General Rate Application hearing.

On behalf of the Board panel, I would like to thank everyone for their cooperation throughout this hearing. This includes, during the hearing, the MPI front row, including: Mr. Graham, Mr. Scarfone, Mr. Guerra, Mr. Johnston, Mr. Wennberg, Mr. Bunko, Mr. Giesbrecht, Mr. Bunston, Ms. Campbell, Mr. Lazarko, and Mr. Remillard. The MPI back row, including, from time to time: Mr. Triggs, Mr. Keith, and Mr. Crozier, Mr. -- Mr. Sprenger, Ms. Jetana (phonetic), Mr. Mira, Mr. Clearwater, Mr. Dressler (sic), Ms. Hora, Ms. Mitra, Mr. Dunstone, Mr. Krupinski, and Mr. Phoa.

The Intervenors and their respective counsel: for CAC, Mr. Williams and Ms. Dilay, and for CMMG, Mr. Oakes.

The witnesses who testified before the board: Mr. Makarchuk, pardon me, Mr. Henry, Dr. Simpson, Ms. Sherry, and Mr. Viola.

The presenters who made submissions this year, I would also like to thank the Secretary of the Board Mr. Christle, and our document manager Ms. Schubert.

Our court reporter, Digi-Tran, including Cheryl -- Ms. Cheryl Lavigne and Ms. Wendy Woodworth; our advisors, Mr. Cathcart and Ms. Martyszenko, and Mr. Pelly; and our counsel, Ms. McCandless, and Mr. Watchman.

The Board also appreciates the members of the public who took time to sit during the course of the hearings, and to follow the proceedings via our livestreaming on the PUB website. The panel will be meeting in the very near future to deliberate and make our final determinations on this matter before us.

This concludes our hearing. Thank you.

MR. STEVE SCARFONE: Thank you.

--- Upon concluding at 1:44 p.m.

Certified Correct,

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Cheryl Lavigne