MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE CORPORATION (MPI)

2020/2021 GENERAL RATE APPLICATION

HEARING

Before Board Panel:

Irene Hamilton, QC	-	Board Chairperson
Robert Gabor, QC	-	Board Chair
Carol Hainsworth	-	Board Member

HELD AT:

Public Utilities Board

400, 330 Portage Avenue

Winnipeg, Manitoba

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Pages 2051 to 2274

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Tamara Edkins	(np)	)of Manitoba
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--- Upon commencing at 10:49 a.m.

THE CHAIRPERSON: Okay. Thank you. Ms. McCandless, do you have any matters to discuss?

MS. KATHLEEN MCCANDLESS: No, not at this time.

THE CHAIRPERSON: Okay.

MS. KATHLEEN MCCANDLESS: I believe it's just for the panel to ask questions --

THE CHAIRPERSON: Okay. Thank you.

MS. KATHLEEN MCCANDLESS: -- and then MPI's re-examine.

THE CHAIRPERSON: Okay. Questions?

MPI PANEL NO. 8 CONTINUED:

BENJAMIN GRAHAM, PREVIOUSLY SWORN
CURTIS WENNBERG, PREVIOUSLY SWORN
CAROL HORA, PREVIOUSLY SWORN
SHAYON MITRA, PREVIOUSLY SWORN

BOARD MEMBER GABOR: Yeah. Ms. Hora, thank you for being here. I'm going to start off by saying that I'm going to go directly against what Mr. Graham said.

I'm going to give you an assumption --

give you a hypothetical situation. And the hypothetical situation is I don't like the weather in Vancouver. So I'm moving back from BC to Manitoba so I can see some sun, and I have to buy some insurance, and you're at the service centre, and you're the person I'm talking to at the service centre to buy some insurance. Okay?

MS. CAROL HORA: Okay.

BOARD MEMBER GABOR: So I'm sitting across the desk from you, and your computer is on. What is on your screen? What are the questions you are asking me that is on your screen in terms of the insurance I want?

MS. CAROL HORA: So our IWS system.

BOARD MEMBER GABOR: Okay.

MS. CAROL HORA: When a customer has been already set up -- so we've got your identity, and you're already scheduled as a customer, and we are setting up a policy for you what will come up on the screen is, first of all, the Basic insurance.

BOARD MEMBER GABOR: Correct.

MS. CAROL HORA: So that would be, like, a -- a line item under the whole -- that would be the first one in a whole list of options of Extension products that would be available to you.

BOARD MEMBER GABOR: Okay. So in terms of the Basic, am I asked what level of third-party liability insurance I want?

MS. CAROL HORA: Yes. But the Basic is $200,000.

BOARD MEMBER GABOR: Two hundred thousand (200,000).

MS. CAROL HORA: Right?

BOARD MEMBER GABOR: And am I -- am I asked, your levels are five hundred thousand (500,000), a million?

MS. CAROL HORA: These are your options.

BOARD MEMBER GABOR: Those are the options.

MS. CAROL HORA: Yes.

BOARD MEMBER GABOR: Okay. And essentially this is what -- for you, this is a -- a checkbox?

MS. CAROL HORA: Yeah. It's -- it's a line item that if you click on it, it's highlighted.

BOARD MEMBER GABOR: Right.

MS. CAROL HORA: So it becomes part of the policy that we're going to sell you.

BOARD MEMBER GABOR: Okay. The next

thing is -- what -- deductible?

MS. CAROL HORA: And it would be the same scenario. The Basic deductible is $500.

BOARD MEMBER GABOR: M-hm.

MS. CAROL HORA: And these are some other options that are available to you.

BOARD MEMBER GABOR: So on the same screen or do you --

MS. CAROL HORA: All on the same screen.

BOARD MEMBER GABOR: It's all on the same screen. What else is on that screen?

MS. CAROL HORA: I happen to have it right here.

BOARD MEMBER GABOR: Okay.

MS. CAROL HORA: So we have Extension -- sorry?

MR. STEVEN SCARFONE: So -- sorry to interrupt, Ms. Hora; you're doing a great job -- I just wanted to say, Mr. Gabor, that those screenshots could be filed as an exhibit.

But we would suggest -- 'cause they might be of some assistance to the Board, we could file them on the confidential module because they do contain some of the pricing for the competitive products. But it might be helpful --

BOARD MEMBER GABOR: Is it possible to have on the public record the screenshots without the pricing?

MS. CAROL HORA: We could redact --

BOARD MEMBER GABOR: Okay.

MS. CAROL HORA: -- the price out of the screenshots.

BOARD MEMBER GABOR: Yeah. I don't -- I don't really care about the prices. I -- I just want to know what the options are.

MR. STEVEN SCARFONE: Yes. So we can do that.

BOARD MEMBER GABOR: Okay.

THE COURT OPERATOR: Is that an undertaking?

BOARD MEMBER GABOR: Yes.

--- UNDERTAKING NO. 35: MPI to provide screenshots of IWS system

MS. CAROL HORA: So other -- other Extension products are also listed. In fact, all of the Extension products would be listed dependent on the vehicle type --

BOARD MEMBER GABOR: Right.

MS. CAROL HORA: -- and the type of insurance --

BOARD MEMBER GABOR: Okay.

MS. CAROL HORA: -- that you select.

BOARD MEMBER GABOR: So I -- I make the choice at that time, and then I assume it generate a -- a policy and a premium?

MS. CAROL HORA: Correct.

BOARD MEMBER GABOR: Okay.

MS. CAROL HORA: And then the options would be offered as far as payments.

BOARD MEMBER GABOR: Okay. And based on Mr. Graham's testimony earlier, you sell the Extension. You're not telling me about your competitor's Extension policies.

MS. CAROL HORA: That is correct.

BOARD MEMBER GABOR: Okay. Now, I -- I want you to answer this if you know it. If not, that's fine.

When the agents -- if I'm going to an agent and I'm sitting across the desk from them and they turn on their computer, is it the same screen they're looking at, or is it a different screen?

MS. CAROL HORA: It is the exact same

screen.

BOARD MEMBER GABOR: Okay. Thank you. Those are my questions.

THE CHAIRPERSON: Thank you. I have one questions for Mr. Graham in relation to a comment that you made about trailing commissions and that the trailing commissions were all paid up front.

Can you provide a little bit more detail? Is it all five (5) years, or is it just with the -- even --

MR. BENJAMIN GRAHAM: No. I'm sorry. I'm sorry for the confusion. I -- I believe that at the time of reassessment if I was to go in and -- or -- I hate the confusion between reassessment and renew, but I -- I pay for my reassessment.

The broker on record would receive that commission in full at that time. So if the policy is canceled -- so I actually love the weather in Vancouver, so I decide I want to move to Vancouver, then I would cancel that policy, move to Vancouver. I would get a pro rata refund of the premium, but the broker would retain all of the commission. Yes.

THE CHAIRPERSON: Thank you. That's very helpful. One other questions that I have for you, Mr. Graham, is in relation to the slide deck that we saw about the shared service delivery model?

MR. BENJAMIN GRAHAM: Yeah.

THE CHAIRPERSON: There were two (2) scenarios, and I believe this was -- it was presented in terms of the rate reductions of 1.7 percent -- and I believe that that was the commission rate reductions -- or 4.4 percent.

And is that something that you would anticipate the public seeing, or is that something that would be there in order to fund the project?

MR. BENJAMIN GRAHAM: No. Those were just parts of the analysis. We just wanted to see what that commission saving if that was to flow back through the Basic product.

If -- if we were comparing apples to apples, the -- if that money went back into the current pricing model in, which we are in front of you asking for today, then it would lead to a reduction in Basic rates of that percentage.

THE CHAIRPERSON: Okay. Thank you. I don't have any further questions. Mr. Scarfone?

MR. STEVEN SCARFONE: Thank you, Madam Chair. Just before I begin my re-direct, we've fallen behind on our exhibits. So I'd like to take a moment to file some exhibits and put them on the record?

THE CHAIRPERSON: Thank you.

MR. STEVEN SCARFONE: MPIC Exhibit number 66 is the quarterly financial report -- the second quarter.

--- EXHIBIT NO. MPI-66: MPIC quarterly financial report of the second quarter

MR. STEVEN SCARFONE: MPIC Exhibit number 67 is a response to Undertaking number 9.

--- EXHIBIT NO. MPI-67: Response to Undertaking 9

MR. STEVEN SCARFONE: MPIC Exhibit number 68 is a response to Undertaking number 11.

--- EXHIBIT NO. MPI-68: Response to Undertaking 11

MR. STEVEN SCARFONE: MPIC Exhibit number 69 is a response to Undertaking number 13.

--- EXHIBIT NO. MPI-69: MPIC to Undertaking 13

MR. STEVEN SCARFONE: MPIC Exhibit number 70 is a response to Undertaking number 16.

--- EXHIBIT NO. MPI-70: Response to Undertaking 16

MR. STEVEN SCARFONE: MPIC Exhibit number 71 is a response to Undertaking number 17.

--- EXHIBIT NO. MPI-71: Response to Undertaking 17

MR. STEVEN SCARFONE: MPIC Exhibit number 72 is a response to Undertaking number 18.

--- EXHIBIT NO. MPI-72: Response to Undertaking 18

MR. STEVEN SCARFONE: And lastly, MPIC Exhibit number 73, it appears to be a revised version of Information Request PUB-1-50.

--- EXHIBIT NO. MPI-73: MPIC revised version of Information Request PUB-1-50

MR. STEVEN SCARFONE: And then lastly, one (1) other housekeeping matter before the re-direct. I understand Ms. Hora would like to go on the record and correct something that was provided on Friday during her evidence.

MS. CAROL HORA: Good morning. Yes. I was questioned on our service levels in the contact centre as far as our call answer time.

I misspoke and provided an incorrect number. So I would like -- just like to clarify that our public calls are target service levels are to answer the calls within one hundred and twenty (120) seconds 70 percent of the time which is what I stated on Friday.

Non-forced broker calls, our target is to answer them within ninety (90) seconds 80 percent of the time which was also correctly spoken on Friday.

The error was in the forced calls from brokers. I stated sixty (60) seconds 80 percent of the time, and it's actually thirty (30) seconds 80 percent of the time.

And I wanted to correct that. Thank you.

THE CHAIRPERSON: Thank you, Ms. Hora. Mr. Scarfone?

(BRIEF PAUSE)

RE-DIRECT-EXAMINATION BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: Thank you, Madam Chair.

Kristen, could you pull up IBAM Exhibit number 8 for me, please?

A question for Mr. Graham. Mr. Graham, you recall counsel for the Insurance Brokers Association put to you this news release following the province having announced your appointment as president of MPI?

MR. BENJAMIN GRAHAM: Yes, I recall.

MR. STEVEN SCARFONE: And if you scroll down, he brought to your attention one more -- thanks, Kristen -- he brought to your attention that highlighted portion there that reads:

"We are confident that he can build on the successes and dedicated leadership of the corporation's current president and CEO Dan Guimond."

Do you see that?

MR. BENJAMIN GRAHAM: I do.

MR. STEVEN SCARFONE: And, sir, you'll also recall that there was a suggestion made, and I think you candidly admitted as much that you didn't have any experience with the Manitoba market when you took this job. Correct?

MR. BENJAMIN GRAHAM: That is correct. I think I've maybe facetiously answered that I was a -- a quick learner.

MR. STEVEN SCARFONE: Yes. No. And I'm not asking about that, but you also indicated that you were able to draw upon the experience of some of the people that were at MPI at the time including Mr. Keith.

MR. BENJAMIN GRAHAM: Yes, that's correct.

MR. STEVEN SCARFONE: And was Mr. Keith available to you in the same -- in the same office? In the same --

MR. BENJAMIN GRAHAM: Yes. Mr. Keith was located -- his office was two (2) doors down from mine.

MR. STEVEN SCARFONE: Okay. And anybody else that you can recall on the executive or perhaps others in senior management that assisted you in your early days as president of MPIC?

MR. BENJAMIN GRAHAM: A-- a lot of the senior staff provided guidance. So just trying to get up to date with the historical events, so again, we've spoken this morning about historical agreements, trying to understand the reasoning behind those.

And just the way -- and again, able to bring private experience into this role, I think, was what was required by the Board of Directors. But I was still learning what the public insurance mandate was all about.

MR. STEVEN SCARFONE: Okay. Thank you. And on another area that -- questions were put to you about the different models that MPIC had designed for its future delivery of services. Do you recall those models, sir?

MR. BENJAMIN GRAHAM: Yes, I do.

MR. STEVEN SCARFONE: And in your evidence, you indicated -- I made a note that MPIC prefers what was called the shared delivery model in that analysis. Do you recall that?

MR. BENJAMIN GRAHAM: Yes, I do.

MR. STEVEN SCARFONE: Can you just briefly explain what it is about the shared delivery model that MPIC likes and why it's preferred?

MR. BENJAMIN GRAHAM: It's a very simple reason. Again, the move to online transactions is a journey that we must -- we must undertake, and we're in the process of doing that.

What I want to be able to do is to make sure that if a customer wants to deal directly with MPI -- and again, without going into the details of compensation and potential savings on commissions that could occur -- if you wanted to go directly through MPI, you would have that choice.

But then if you wanted to go through a broker, you might potentially go into a broker, not have time to do the transaction there, and then go home and go through their website so they receive appropriate commissions. I don't have an issue with that either.

So I just want to make sure that we're really opening the door for customers to transact with us in any way possible.

MR. STEVEN SCARFONE: Okay. Thank you. And, Kristen, IBAM-15, please?

This article was put to you, Mr. Graham, by counsel for the Insurance Brokers Association, and a quote was read back to you from Ms. Jardine. Do you recall that?

MR. BENJAMIN GRAHAM: Yes, I do.

MR. STEVEN SCARFONE: I keep going -- next page, I believe. Right there.

So I had a follow-up question on this

particular quote. It reads:

"Anyone who thinks it's easy to direct insurance is extremely naive."

Can you explain what she means, if you can, by "direct insurance"?

MR. BENJAMIN GRAHAM: I think what Ms. Jardine is referring to is that when they went into a new province of Quebec to do business, the bricks and mortar model are only providing services online direct to customers in a province that you don't have a strong footing in would be extremely difficult to get the level of market share and be able to technically price products appropriately to be profitable.

So for them, I believe it was difficult to do so, and therefore, taking a step back, they felt that the distribution of their products as customers in Quebec would potentially go to a broker or go through an online portable -- portal that compares private products. That was a more cost efficient way of doing it.

MR. STEVEN SCARFONE: Okay. So when she goes on to say there that the:

"The one thing I know is that

brokers look after their customers
better than the directs."

Is that kind of meaning the same thing? So that -- I know this is from the -- an article from an insurance magazine but the underwriter -- but what does that mean, better than directs? Like, that seems to be some insurance lingo that --

MR. BENJAMIN GRAHAM: I -- I think in a -- in a private market selling consumer line products, the market is demanding in that private market to really ask for a comparison and that customer choice.

So instead of customers going to eight (8) different direct websites, they could simply go through a broker and get -- get the rating engine to do it for them.

MR. STEVEN SCARFONE: I see. Okay. And so that brings me to my next point. Counsel for the Insurance Brokers Association also pointed out to you and the panel members the SGI accord, that is the remuneration agreement that SGI has with its brokers. Correct? You recall that?

MR. BENJAMIN GRAHAM: Yes, I do.

MR. STEVEN SCARFONE: And I guess the first question is: Does MPIC in any way feel compelled to do what the Saskatchewan Government Insurance people are doing?

MR. BENJAMIN GRAHAM: No. We are not compelled at all.

MR. STEVEN SCARFONE: Okay. Are you familiar at all with the model that the Saskatchewan general insurance uses?

MR. BENJAMIN GRAHAM: Yeah. I -- I believe the reference was probably in relation to how brokers are a part of their online transaction process.

So the way that it works there is that a customer would go to a -- potentially a -- a broker's website. There's two (2) ways to do it. You could either go through a broker's website, and then there would be a simple link to "MySGI," which is the primary system, something similar to what we want to do here.

The other way would be that you would just go straight to MySGI and at the time of final transaction -- so once you've picked your policy, you would then have a drop-down menu where you select a broker of record, and they would receive the commission on that transaction.

So you could potentially not even go

through a broker website to gain any further information, and all -- all the information would be on the SGI website anyway. But you are forced to select a broker whether you've spoken to one or not.

MR. STEVEN SCARFONE: So the MySGI sounds like a customer account of sorts?

MR. BENJAMIN GRAHAM: That's correct.

MR. STEVEN SCARFONE: And that's -- that's accessed directly through the Saskatchewan Government Insurance website?

MR. BENJAMIN GRAHAM: Yeah. You can do it either way. So the -- yeah. There would be a link either on a broker website or it would be directly through the -- the government portal.

MR. STEVEN SCARFONE: And also there was some reference to the accord that the British Columbia people have in place with their brokers. Are you familiar with that particular agreement?

MR. BENJAMIN GRAHAM: Yes, I am.

MR. STEVEN SCARFONE: And, again, is MPIC compelled to -- to do what the people in British Columbia are doing?

MR. BENJAMIN GRAHAM: Not compelled but same as the SGI model. I think we obviously apply better -- what we consider better practice in the

Manitoba context.

There are some parts of that that we are very aware of. There is the -- we had some discussions earlier this morning with Mr. Williams about a messenger model or a rate card.

We're very well aware of -- well, we're starting to become more aware of the implications around the Competition Act, and the way that ICBC have dealt with it is through that R-ish (phonetic) messenger model.

So we are looking at the different models and how they deal with such a large body versus, you know, something like, you know, when we discussed the -- the rental car industry, it's probably easier to go down a rate card type of model there as compared to something like a -- an Irish messenger model.

But we are aware of it, and it's on the radar. We're just looking into it now and how we apply that on any future discussions that we have with representatives of a -- of a customer base.

MR. STEVEN SCARFONE: So the ICBC model employs, what you're calling, an Irish messenger model?

MR. BENJAMIN GRAHAM: Yes, that's

correct.

MR. STEVEN SCARFONE: And what about the SGI model? Do you know if it does as well?

MR. BENJAMIN GRAHAM: No. I believe that it's negotiated.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: Thank you. Kristen, could you pull up the revised version of IBAM Exhibit number 11, please?

(BRIEF PAUSE)

MR. STEVEN SCARFONE: Mr. Wennberg, do you recall counsel for the Insurance Brokers Association bringing this document up on the screen on Friday?

MR. CURTIS WENNBERG: Yes, I do.

MR. STEVEN SCARFONE: And if I understood, what this document shows is that using the commissions that were paid out in the starting year, 2009/2010, of 69 million, other than the -- the very immediate successive year, the commissions are not, in his view, keeping up with the Canadian price index.

Is that right?

MR. CURTIS WENNBERG: That's correct.

MR. STEVEN SCARFONE: And are you able to say, sir, when it was -- what year the Corporation moved from the one (1) year renewal to the five (5) year?

MR. CURTIS WENNBERG: It was 2010. So the expectation for the commissions, as you've seen in that 2008 agreement, was the -- the commissions for not doing work in years two (2), three (3), four (4), and five (5) of a five (5) year renewal was supposed to result in -- in less overall compensation. There was some ma -- mitigating factors for it, but it was implied to be less.

What you see on this chart is that it -- it still actually increased on an absolute level, and it increased to almost the rate of inflation as well.

MR. STEVEN SCARFONE: But so in 2010 and '11, or perhaps the next year, the number of transactions performed by the brokers would have decreased?

MR. CURTIS WENNBERG: Correct.

MR. STEVEN SCARFONE: And that's due to the new renewal of the driver's licences?

MR. CURTIS WENNBERG: Correct. Customers didn't need to go to a broker's to -- to -- shop to change any of their reassessment years, meaning year two (2), three (3), four (4), and five (5). And what we see in that period is that most of them are clean assessments, and -- and they just aren't changed. The policies really don't change that much.

MR. STEVEN SCARFONE: Thank you. And then, again, for Mr. Wennberg, do you recall counsel for the insurance brokers' association had some questions of the panel about the possible loss of the sale of Extension products if the Corporation was to go online? Do you recall that?

MR. CURTIS WENNBERG: Yes.

MR. STEVEN SCARFONE: And the reason for that, as I understood his argument, was that the Manitoba customer is not a sophisticated customer, or what he called mature. Do you recall that?

MR. CURTIS WENNBERG: Yes.

MR. STEVEN SCARFONE: And that their -- Manitobans are notorious for being frugal or seeking out deals?

MR. CURTIS WENNBERG: Yes.

MR. STEVEN SCARFONE: So is there

anything, and I appreciate that the Corporation hasn't designed its -- its online -- its proposed online services -- but is there anything that the Corporation has in mind that would guard against a customer not selecting insurance products that he or she had previously purchased through a broker?

MR. CURTIS WENNBERG: Yes. And we -- we covered some of these ideas in -- in -- in the hearing. There was also a comment around if someone had been drinking, how could we -- how could we make sure that they're protected in their transaction, and -- and -- and it's very interesting.

When you think about it, what -- what my colleague, Mr. Graham, was saying is that we're looking at a shared model. So this issue applies whether they're going through an insurance broker site or the MPI site. We would look at things that would be potentially giving customers what their existing insurance selections were so that they at least know that if they're making a change, they may want to think a little bit more about making a change.

Or for things like third-party liability, there's a -- a callout box or some 'are you sure' type of moment that they double-click on. But we would also expect those types of failsafes to exist in -- in a -- in a broker experience as well if they're -- if they're purchasing online. So -- so -- so there's other -- there's other elements that -- that we could have.

And then finally, if someone does make a change on their insurances, we could send them a hard copy to their house. A reminder is that MPI folks don't get paid bonuses. We wouldn't get paid commissions on the basis of selling any additional third-party pieces. So if -- if in -- what happens is if our customer base naturally starts choosing different selections on their own merits, you know, that -- that -- that would be interesting for us to -- to learn.

But -- but we think the customer, you know, sitting in front of a computer can sometimes make very informed choices. They don't necessarily need someone to take them through that. So there's lots of failsafes for -- for those clients.

MR. STEVEN SCARFONE: Thank you, Mr. Wennberg. And then just one (1) last question that arose from a question from Panel Member Gabor to Ms. Hora.

Ms. Hora, Mr. Gabor was asking you about the -- the screens that a broker or MPI employee looks at when selling insurance to a customer. Do you recall that?

MS. CAROL HORA: Yes, I do.

MR. STEVEN SCARFONE: And the screens that the MPI employee looks at are the same as those that are before the broker?

MS. CAROL HORA: That's correct.

MR. STEVEN SCARFONE: And the Extension products are on those screens?

MS. CAROL HORA: Yes, they are.

MR. STEVEN SCARFONE: But Mr. Gabor asked you about any Extension products that might be offered by competing insurers. Remember that?

MS. CAROL HORA: Yes, I do.

MR. STEVEN SCARFONE: And those aren't on the screens?

MS. CAROL HORA: No, they're not.

MR. STEVEN SCARFONE: And is there anything that would prevent the broker from offering such products to a customer when attending at a broker's office?

MS. CAROL HORA: No, there's nothing that would prevent a broker from offering a product other than MPI's product. They have that information. It's just not on the same screen.

So they're selling the Basic insurance through our Autopac online system. They have access to all of the other insurers' information that they typically sell for as well. So it would just be one (1) extra step to go and look at some other options for the customer.

MR. STEVEN SCARFONE: And that, I guess, assumes that that broker is trained and knowledgeable as to the other products that might be available for the customer.

MS. CAROL HORA: That would be true, yes. Yeah.

MR. STEVEN SCARFONE: Oh, and -- sorry. My co-counsel has reminded me that Ms. Hora fell into that acronym trap earlier in her testimony. IWS
is the system that she referred to. That is an acronym for Insurance Work Station, and that's the one that's shared between the brokers and Manitoba Public Insurance.

So those are all my questions on re-direct, Madam Chair. Oh, yeah, Mr. Graham wants to add something.

MR. BENJAMIN GRAHAM: I -- it was remiss of me. You surprised me with the question about the -- the two (2) different -- or the ICBC accord, and I just wanted to touch on -- when I -- when I spoke about -- there was a specific provision there about the Competition Act and that the credit unions' association as well as the brokers' association are -- are very well aware of it, and they accepted they must be in compliance with that.

The focus for us as we look at this is really about making sure that MPI is in compliance, so it's more of a compliance issue. And again, I think we've discussed, there are a number of different models that you can implement to ensure compliance with the Competition Act. So again, they're the -- they're the types of conversations, but our first and foremost concern is making sure that we as a Corporation are in compliance with that.

MR. STEVEN SCARFONE: Thank you.

(PANELS STANDS DOWN)

THE CHAIRPERSON: Thank you. We'll break for lunch now, and be back at one o'clock. Is that when you're anticipating your witnesses will be here?

DR. BYRON WILLIAMS: Yes.

THE CHAIRPERSON: Okay, thanks Mr. Williams. We'll see everyone at one o'clock. Thank you.

--- Upon recessing at 11:17 a.m.

--- Upon resuming at 1:00 p.m.

THE CHAIRPERSON: Good afternoon, everyone. This afternoon we will have the witnesses for the Consumers' Association of Canada. Mr. Williams...?

DR. BYRON WILLIAMS: Yes, and I'll introduce the witnesses, and then after that, ask that they be sworn or affirmed.

And to my immediate right is Ms. Andrea Sherry. To her right is Dr. Wayne Simpson, and to his right is Mr. John Todd. And in the back behind Mr. Todd is our own back row this time, Ms. Alicia Dueck-Read, Robson Hall third year law student. To her left is Ms. Desorcy, my boss, and ED of the Consumers' Association. And to her left is Chris Klassen, articling student at law.

And I'll ask that the witnesses be sworn or affirmed.

CAC WITNESS PANEL:

ANDREA SHERRY, Sworn
WAYNE SIMPSON, Sworn
JOHN TODD, Affirmed

DR. BYRON WILLIAMS: Madam Chair, before we introduce the exhibits, I'll just confirm my understanding and -- and ask MPI counsel to confirm that they are not contesting the qualifications of Mr. Todd?

MR. STEVEN SCARFONE: Yes, Madam Chair. MPIC consents to the gentleman's qualifications.

THE CHAIRPERSON: Thank you.

DR. BYRON WILLIAMS: Madam Chair, there's two (2) PowerPoints that should be before the -- the panel, one (1) titled 'Protecting Consumers Against Risk: How Far Should it Go'. And we would ask that -- that be marked as CAC Exhibit 16.

--- EXHIBIT NO. CAC-16: 'Protecting Consumers Against Risk: How Far Should it Go' PowerPoint

DR. BYRON WILLIAMS: And the second is an assessment of the Capital Management Plan of MPI. Clearly, Mr. Todd does not have Dr. Simpson's gift for -- for nice, glib titles. And we'll ask that -- that be marked as CAC Exhibit number 17.

--- EXHIBIT NO. CAC-17: Assessment of the Capital Management Plan PowerPoint

EXAMINATION-IN-CHIEF BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: Before we get into the exhibits, we will -- recognizing that these witnesses have been prequalified, we will just highlight a -- a few of their -- the -- the credentials that do give them insight, starting with you, Ms. Sherry.

MS. ANDREA SHERRY: M-gm.

DR. BYRON WILLIAMS: In terms of your education, you hold a bachelors of commerce with a major in actuarial math -- mathematics? Your mic, please.

MS. ANDREA SHERRY: That's correct.

DR. BYRON WILLIAMS: And you became a fellow of the Canadian and -- the Casualty and Actuarial Society, and of the Canadian Institute of

Actuaries in the year 2000?

MS. ANDREA SHERRY: That's right.

DR. BYRON WILLIAMS: You became a chartered risk manager and a fellow chartered insurance professional in 2005?

MS. ANDREA SHERRY: Correct.

DR. BYRON WILLIAMS: And you received a certified management accountant designation in 2008, agreed?

MS. ANDREA SHERRY: Correct, yeah.

DR. BYRON WILLIAMS: And in terms of your professional experience as an actuary, you served at Manitoba Public Insurance as an associate actuary between 1991 and 1998, correct?

MS. ANDREA SHERRY: That's correct.

DR. BYRON WILLIAMS: You also served as an actuary with the Federated Insurance Company from 1999 through 2004?

MS. ANDREA SHERRY: That's right.

DR. BYRON WILLIAMS: You served as both assistant vice-president and corporate actuary for Saskatchewan Government Insurance between 2004 and 2008, correct?

MS. ANDREA SHERRY: M-hm. Yes.

DR. BYRON WILLIAMS: And from 2008 to

2011, you served as vice president, solvency, and vice president, corporate actuary for Aviva?

MS. ANDREA SHERRY: That's right. Yeah.

DR. BYRON WILLIAMS: And your current position is vice president, personal -- personal insurance at the Wawanesa Mutual Insurance Company?

MS. ANDREA SHERRY: Yes.

DR. BYRON WILLIAMS: And there you are responsible for a number of duties, including the company's actuarial pricing?

MS. ANDREA SHERRY: That's right.

DR. BYRON WILLIAMS: Prior roles include work in solvency, and capital, and Enterprise risk management, correct?

MS. ANDREA SHERRY: Correct.

DR. BYRON WILLIAMS: And you have worked on dynamic capital adequacy testing and internal models to satisfy regulatory requirements in the United Kingdom?

MS. ANDREA SHERRY: Correct.

DR. BYRON WILLIAMS: And in terms of your work before the Public Utilities Board, you've consulted on MPI applications for the last eight (8) years, including providing evidence on the last three

(3) years on issues related to the rate stabilization reserve, and accepted actuarial practice?

MS. ANDREA SHERRY: That's right, yes.

DR. BYRON WILLIAMS: And Ms. Sherry, with Dr. Simpson, you were co-author of the written evidence filed as CAC Exhibit 12-1, entitled 'Protecting Consumers Against Risk: How Far Should it Go'?

MS. ANDREA SHERRY: That's right.

DR. BYRON WILLIAMS: You were also responsible for information resp -- request responses contained within PUB Exhibit 15?

MS. ANDREA SHERRY: That's right.

DR. BYRON WILLIAMS: And can you confirm that this written material was prepared jointly under your and Dr. Simpson's direction and control, and is accurate to the best of your knowledge and belief?

MS. ANDREA SHERRY: Yes.

DR. BYRON WILLIAMS: Thank you. Dr. Simpson, good afternoon.

DR. WAYNE SIMPSON: Hello.

DR. BYRON WILLIAMS: Dr. Simpson, you received both an MSc in economics and a PhD in economics from the London School of Economics, sir?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: And you are currently a full professor in the Department of Economics at the University of Manitoba, where you have taught since 1979?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: And you have served as department head of that department on at least two (2) separate occasions, sir?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: You have co-authored or authored three (3) books and more than sixty (60) peer-revor -- veered -- peer-reviewed articles, sir?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: And are on the Editorial Board of Canadian Public Policy, Canada's foremost peer-reviewed academic Journal for economic and social policy?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: You were the 2014 recipient of the McCracken award for the development and analysis of economic statistics from the Canadian Economics Association?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: And in terms of your experience before the Public Utilities Board in the context only of MPI, you've testified in the 2007, 2010, 2013 through 2019 general rate applications, sir?

DR. WAYNE SIMPSON: That's right.

DR. BYRON WILLIAMS: And that's been on issues such as the rate stabilization reserve, interest rate forecasting, and issues related to investment?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: And sir, with Ms. Sherry, you were responsible -- co-author of the written evidence filed as exhibit CAC 12-1?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: You are also responsible for Information Requests contained within Exhibit PUB-15 with Ms. Sherry?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: And can you confirm that the written material was prepared under your direction and control, and is accurate to the best of your knowledge and belief, sir?

DR. WAYNE SIMPSON: Yes.

DR. BYRON WILLIAMS: Good afternoon,

Mr. Todd.

(BRIEF PAUSE)

MR. JOHN TODD: Good afternoon, panel members.

DR. BYRON WILLIAMS: I was expecting a little more adeptness with the microphone, given your engineering background, sir.

MR. JOHN TODD: Well, my engineering background's a little rusty, I'm afraid.

DR. BYRON WILLIAMS: You received a batch -- a bachelors of applied science in electrical engineering from the University of Toronto in 1972?

MR. JOHN TODD: Correct.

DR. BYRON WILLIAMS: And you also have a Masters in business admin -- administration, again from the University of Toronto, in 1975?

MR. JOHN TODD: Correct.

DR. BYRON WILLIAMS: You founded Elenchus -- what is now known as Elenchus Consulting Services -- in 1980, sir?

MR. JOHN TODD: Correct.

DR. BYRON WILLIAMS: And in your work with what is now known as Elenchus, you have specialized in government regulation for over forty (40) years, sir?

MR. JOHN TODD: Correct.

DR. BYRON WILLIAMS: Among other issues, you have addressed issues related to price regulation and deregulation, market restructuring to facilitate effective competition, and regulatory methodology?

MR. JOHN TODD: Yes, that's the core areas of my work.

DR. BYRON WILLIAMS: And your work has included advising clients and preparing expert evidence with respect to the appropriate capital structure for Crown corporations and the relationship between Crown corporations and unregulated lines of business, agreed?

MR. JOHN TODD: That's correct.

DR. BYRON WILLIAMS: And that has included applicable regulatory principles?

MR. JOHN TODD: Yes.

DR. BYRON WILLIAMS: And the sectors of primary interest in recent years for you have included electricity, natural gas, and telecommunications, correct?

MR. JOHN TODD: Yes, for the past

thirty (30) years.

DR. BYRON WILLIAMS: You have assisted counsel in over two hundred and fifty (250) proceedings, and provided expert evidence in over one hundred (100) hearings?

MR. JOHN TODD: Correct.

DR. BYRON WILLIAMS: Your clients have included consumer groups, regulated companies, producers, competitors, regulators, and governments, sir?

MR. JOHN TODD: That's correct.

DR. BYRON WILLIAMS: And on behalf of the Insurance Corporation of British Columbia, you provided expert evidence on the financial allocation methodology of ICBC, the Insurance Corporation of British Columbia, before the British Columbia Utilities Commission, sir?

MR. JOHN TODD: That's correct.

DR. BYRON WILLIAMS: You also participated on behalf of the Insurance Corporation of British Columbia in a financial allocation workshop in 2005, correct?

MR. JOHN TODD: Yes.

DR. BYRON WILLIAMS: And you have served, sir, as an independent consultant to regulators in five (5) Canadian provinces, including the Manitoba Public Utilities Board, the Onor -- Ontario Energy Board, the Quebec Regie, the Alberta Utilities Commission, and the BC Utilities Commission, sir?

MR. JOHN TODD: Four (4) of the five (5) were proceedings. The Alberta Utilities Commission was internal work, or the -- for the -- for the Commission.

DR. BYRON WILLIAMS: Thank you. And you have provided expert assistance in a total of forty-six (46) proceedings before the Public Utilities Board of Manitoba from 1990 to 2017, sir?

MR. JOHN TODD: I believe your count. I didn't -- I can't confirm. I didn't do that count myself.

DR. BYRON WILLIAMS: Okay. And with respect to Manitoba Public Insurance, you provided expert evidence with respect to the rate stabilization reserve and related issues in the 2006 General Rate Application, the 2002, 2000, 1999, and 1998 General Rate Applications, sir?

MR. JOHN TODD: Correct.

DR. BYRON WILLIAMS: And Mr. Todd, you have prepared evidence for this proceeding filed as

Exhibit CAC-11 entitled 'An Assessment of the Capital Management Plan of Manitoba Public Insurance for the 2021 General Rate Application Based on the Generally Accepted Regulatory Principles'?

MR. JOHN TODD: Correct.

DR. BYRON WILLIAMS: And you were also responsible for Information Requests contained within Exhibit PUB-15?

MR. JOHN TODD: Correct.

DR. BYRON WILLIAMS: Can you confirm that that written material was prepared under your direction and control, and accurate to the best of your knowledge and beliefs, sir?

MR. JOHN TODD: Yes, I can.

DR. BYRON WILLIAMS: Okay. Thank you. We're going to turn now to CAC Exhibit 16. And I'll turn it over to Dr. Simpson and Ms. Sherry, and try not to interrupt too much.

DR. WAYNE SIMPSON: Okay. Thank you. Although it may not be apparent from the title, this is really 100 percent about the 100 percent MCT criterion for rate setting, which is associated with the Capital Management Plan. It's a fairly short presentation, I guess at least by my standards. And I'll go through it fairly directly. So next slide, please.

So the Capital Management Plan in the 2020 GRA applies for approval of -- of premiums. That's based on the CMP, which establishes a means and pathway to achieve 100 percent minimum capital test MCT for the Basic rate stabilization reserve, the RSR, as codified in the reserves regulation, and that is really the focus of this presentation. Next slide, please.

We have two (2) concerns that we'd like to express about this approach, both of which involve the notion of significant changes. The first one is a significant change in procedure regarding the -- the target level of capital for Basic insurance and the associated rate stabilization reserve.

And I'll talk a little bit briefly, because we talked about this last year, about the way in which it is a significant change in procedure, and also the fact that it changes the approach from a target range to a target level, which I think is also somewhat problematic for a rate stabilization.

The second one is that it's a significant increase in level of risk, which MPI ratepayers would be protected from without any evidence of increasing downside risk to MPI and to rates. So I'll take these two (2) issues in turn. Next slide, please.

The first issue around a significant change in procedure for rate setting, our report last year, which is attached as appendix, goes into some detail in these developments over time, since the Kopstein report in 1988. They're briefly summarized here.

The Kopstein report looked at this issue for the first time and started the ball rolling, so to speak, and established a range of 10 to 20 percent of premiums, with a target, if you will, if you want to think of the midpoint as a target, of 15 percent. And this is the so-called percentage of premiums approach that was used for quite a period of time.

In 2000, there was an attempt to relate the risk stabilization reserve and its range to the actual risks in terms of the variability of MPI's operational income. And this involved the establishment of the 95 percent confidence interval of 1:40 year risk of insufficient RSR to cover underwriting losses.

DR. BYRON WILLIAMS: Dr. Simpson, could I just stop you there? I think you said 95 percent?

DR. WAYNE SIMPSON: Ninety-seven point five (97.5) percent, I'm sorry.

DR. BYRON WILLIAMS: Okay.

DR. WAYNE SIMPSON: I can't even read my own notes which is a 1:40, as I'll explain a little more below.

And this 1:40 year standard for risk tolerance was endorsed by the Board in Board Order 150/'07. And I think this was the -- the main thing that came out of that discussion, because the RE-VAR (phonetic) approach was never directly used, as far as I know.

And the reason was really that there was fairly limited data. There were only about eighteen (18) years of evidence on the -- what we would now call the total equity of outcomes of MPI, and that would -- was sensed to be insufficient to have a reliable estimate of the 97.5 percent confidence interval. But the basic idea there is a fairly sound statistical principle for analyzing what you would characterize as risk when you have volatility in net income.

The third stage was the dynamic capital adequacy test, which was initially used to -- to assess future financial condition of Basic, but later on became MPI's justification for the RSR target, continuing to use this 1:40 year risk standard. And it was -- achieved considerable consensus, because it was based on historical evidence. It was quite transparent, and there was a clear discussion available of how the risks of MPI could be justified and addressed using the RSR. And the utility of the RSR -- of the -- sorry, the DCAT for setting the Basic capital target was recognized by the Board in Board Order 162-'16, just three (3) years ago.

In addition to that, however, there was -- sorry, next slide, please -- in addition to that, there was the MCT, minimum capital adequacy test, which appeared as early as 2005, where MPI in 2007 recommended the RSR target range of 50 to 100 percent MCT.

The MCT is recognized by OSFI for private casualty insurers in a competitive insurance industry to present -- to -- to prevent insolvency. But the concern has always been in our discussions that MPI is neither a public -- a private casualty insurer, nor a competitive insurance industry, nor are we really concerned about preventing insolvency.

MPI is a public Crown Corporation,

which in economic terms is not competitive, because it has a dominant -- virtually a monopoly position over Basic insurance. And the issue has always been to stabilize rates and prevent what is referred to as rate shock, rather than to prevent insolvency.

And so MPI has a quite different risk profile than a -- a private insurer in a competitive industry, and it isn't clear that the 100 percent or any other standard would be appropriate, and what criteria would be used to set that standard.

DR. BYRON WILLIAMS: Dr. Simpson, if I could interrupt you there for one (1) question for you, then have a question for Ms. Sherry.

You used the acronym OSFI, O-S-F-I. Can you tell us what that stands for, sir? Or does it stand for the Off -- Office of the Superintendent of Financial Institutions, at the risk of leading?

DR. WAYNE SIMPSON: Thank you. I drew a blank. Yes.

DR. BYRON WILLIAMS: I thought I'd freeze you with that one, sir.

Ms. Sherry, dismayed at Dr. Simpson's performance on OSFI, I'm going to turn to you for a second. And can you provide additional elaboration on what makes the minimum capital test substantively different from the dynamic capi -- capital adequacy test approach as applied to Manitoba Public Insurance for rate setting?

MS. ANDREA SHERRY: Sure. So the MCT test is calibrated using private insurance company results. These private insurance companies are federally regulated, and they write different products in different provinces. They have different goals and structures from each other for sure, and as well as from MPI.

Again, the MCT was calibrated based on companies' experience. Private companies offering multiple complex products in different provinces with complex capital structures that are very different from the structure of MPI.

Another thing is that MPI doesn't face the competitive risk that a private insurance company would in the sense that it can't price itself out of the -- out of the market, and therefore be unable to pay for its obligations.

MPI is before PUB every year to go through this process to make sure that their rates are adequate. So within that year, it's very different sometimes for a private insurance company that do not have the regulatory oversight that the PUB gives MPI.

A lot of lines are unregulated in the private world.

Some are, like auto. But for sure, an insurance company doesn't have to be before a Board to prove the need for their rate every year.

And I -- I guess that's part of the point, is that when we talk about the DCAT for MPI, DCAT uses MPI experience and risk with probability distributions that come from Manitoba experience. So it's much more applicable.

DR. BYRON WILLIAMS: And in terms of the DCAT, how would you compare the product in Manitoba that the DCAT is measuring as compared to the product that the minimum capital test is measuring in different pra -- across Canada?

MS. ANDREA SHERRY: Well, that's just it, is the DCAT as used by MPI, as determined by MPI, is based on the experience of that company with its one (1) auto product in Manitoba specifically, while the MCT was calibrated for companies that rate multiple products in multiple jurisdictions, sometimes multiple countries.

DR. BYRON WILLIAMS: Thank you. And Dr. Simpson, I'm going to turn it back over to you with apologies for interrupting, sir.

DR. WAYNE SIMPSON: So in spite of

these concerns about the appropriateness of the MCT for a public Crown Corporation, the proposal had been made by MPI to base the RSR target, or target range, or the upper threshold on MCT. And in particular, the upper threshold was presented on a couple of occasions and explicitly rejected in favour of the DCAT scenario testing, and -- in Board Order 162/'16 in 2016.

The current rate application relies on the cabinet reserves regulation to use the 100 percent MCT to set the capital target level, not a range for the Basic under the CMP. And this reverses, really, what I observe, that we've argued for, is the natural progression to link the target capital level to identifiable risks.

The problem with the Kopstein percentage of premiums approach is, of course, it had no relationship to risk, other than insofar as it captured the growth in the business as it was identified by premiums. That moved from that to the RE-VAR (phonetic) approach, which attempted to look at the risks in statistical terms, but was limited by lack of data to the DCAT, which provided an opportunity to look at adverse scenarios using the best available evidence, and did succeed in the minds of me, anyways, of Andrea and me, to deal with the questions of the risks that were facing the Corporation that could be identified and analyzed.

And it eliminates -- the use of the MCT eliminates, really, the useful role of the DCAT in setting the capital -- the target capital level. The GRA states that it -- the DCAT would only assess satisfactory financial conditions and support Enterprise risk management in some unspecified fashion, and I'll say a little more about that later. Next slide, please.

The final aspect of the first concern that we have is the question of the target range. I have a slightly clumsy diagram at the bottom of the page, where you can imagine total equity moving from left to right. And you can imagine in the case of setting a target capital range, that we would have a lower threshold 'L', and an upper threshold 'U' for target capital.

And the argument since the Kopstein approach, the percentage of premiums approach, has, I think, been a -- a fairly clear and sensible one, which is that if Basic falls below the lower threshold, then we'd call for a -- a capital rebuild. If capital falls in the range between the lower threshold and the upper threshold, then there would be no action. There'd be rate stability. And if capital exceeds the upper threshold, then there would be a case for some sort of premium risk -- remittance, capital unbilled, if you will.

And so those are the three (3) options that were discussed in the context of the range from Kopstein right through the RE-VAR (phonetic), which also established a range through the DCAT, which was used to establish a range in previous GRAs.

On the other hand, if you have a target capital level such as the 100 percent MCT, it seems to me this invites some rate instability, which is contrary to the whole idea behind the RSR. You can imagine, for example, a case where you have total equity appearing in alternately between the red line and the green line on each side of the target capital level, which is 'T', which is 100 percent MCT level in the Capital Management Plan.

In that case, rates are going to move. They're going to bounce around on the basis of the discrepancies from -- from the target.

On the other hand, if we were using a range from 'L' to 'U', they wouldn't bounce around at a. So there'd be rate stability under a range. There's some rate instability.

Now, some of that is moderated -- I've read some of the testimony -- by the fact that the movement towards 'T', say, from either the red line or the green line would be slow over time. It wouldn't be immediate, but there would still be rate instability associated with that. So next slide, please.

So the second issue is this question of risk tolerance and the hundred percent MCT is a significant increase in what we would call the risk protection that motorists would be forced to buy under the premium determination.

The long-established per -- purpose of the RSR, and I'll read this again, although it -- it's been in every GRA that I can remember, protect motorists from rate increases that would otherwise have been necessary due to unexpected variances from forecasted results, and due to events and losses arising from nonrecurring events or factors.

So the idea has always been that bad things will happen that can't be predicted that are kind of thought of as one-offs, a -- a huge weather event, a -- a collapse of the stock market. These are the kinds of things that have been envisaged as the things that might produce a situation where there'd be a compelling case for a substantial increase in risk -- in premiums, and what we would call rate shock.

Well, rate shock is really saying that if you have rate instability, there's a certain level of rate instability over which consumers would find -- have some concern, and that would be when premiums go up above a specified amount. And in the Capital Management Plan, in fact, I think the 5 percent rate premium increase is identified there as rate shock.

These are fairly arbitrary numbers, but nonetheless, this is the concern that actually motivated the development of the RSR under the percentage of premiums approach in the Kopstein report.

Earlier GRA hearings and -- and the technical conferences focused on understanding downside risk, quantifying these risks, and relating them to some reasonable motorists risk tolerance standard, the 1:40 year standard, using in later years, the dynamic capital adequacy test and its methodology.

But from an economic standpoint, we have to understand that the RSR involves some fundamental trade-offs, how most economy -- economists view questions of scarcity and choice.

Motorists, if they have a choice, can have more and more rate stability -- or more and more rate stability insurance, more protection, by paying higher premiums and having MPI retain the surplus in the RSR. There's a limit to this. Absolute protection is prohibitively expensive. You'd have to have an absolutely huge reserve, very large RSR to mat -- all the imagined bad things that could happen, the things that keep us awake at night -- and would divert motorists' disposable income into MPI coffers and at the expense of other goods and services, potentially misac -- misallocating resources.

In particular, if rates were so high to offer fantastic reception -- percep -- protection against the risk of premium increases that were untenable -- rate shock -- it might be the case that people couldn't put food on the table.

So proper resource allocation requires determination of motorists' general appetite for risk in terms of rate shock, or what we would call the risk tolerance. And then the question is: What is the appropriate risk tolerance?

So if we go through what we have learned in the past, first of all, for the risk tolerance standard, we have the Board Order 150/07, which endorsed the one (1) in forty (40) year standard in the context of the RE-VAR (phonetic) in 2007. And this was a statistical analysis, so there's a good reason for the one (1) in forty (40) year standard that I'll come to in a moment.

But it said that the RSR should be large enough to be able to withstand an unforseen loss of a magnitude not anticipated to occur more than 1:40 years. In the event of loss of such a magnitude depleting the RSR, possibly even driving it into deficit, the Board would examine with the Corporation the -- and Interveners' options to rebuild the RSR, which could include premium surcharges over a period of years.

In the past, when the situation warranted it, the Board approved moder -- modest rate surcharges for a series of years, just as suggested above. Now, this 1:40 year standard is a widely est -- adopted statistical convention. It's used, for example, in hypothesis testing, where it's recognized that you can protect yourself more and more against the risk, if you will, of rejecting a false hypothesis, but there's increasing cost, which is you'll accept -- you'll -- you'll accept hypothesis that is false.

So when you weigh these, you tend to look at the balance of risk, okay, understanding that you can buy and -- buy more protection against a risks -- risk of rejecting a -- a -- a -- a true hypothesis, when you -- at the cost of greater loss, on the other side. For motorists, it's a protection against increased premiums due to rate shock, due to some unforeseen event, against much higher -- at the cost of higher premiums. And the suitable balance, as shows in statistics, is typically 2.5 percent, or a 1:40 year standard.

The third bit of evidence, if you will -- or maybe the second bit, I guess, because the first two are closely linked -- is that motorists' risk tolerances were the subject of a focus group conducted by Probe Research in 2015 and commissioned by the Consumers' Association of Canada.

And the participants were asked to indicate the magnitude of event from which they wished to be protected by placing their name on the line with the 1:200 year event on the right-hand side of the scale -- very high risk protection -- and a 1:1 event on the left-hand side of the scale -- virtually no risk protection at all.

It was further explained that the

premiums associated with the coverage for the rad -- adverse events that can be expected every year would be minimal, while there would be much higher costs associated with premiums for an event occurring once in every two hundred (200) years. So the framework, I think, here was -- was quite appropriate to the question, which is, how much more are you willing to pay for additional risk protection?

The focus group's conclusions -- most females were comfortable having coverage prot -- sufficient to protect them against a 1:10 year event, with most men preferring coverage near 1:20 years. And I co -- would add here at the end because it talks about an older gentleman, and I guess I qualify in that category -- an older gentleman indicated that his satisfaction with a 1:5 year protection was premised on his advanced age and the unlikelihood that he would live long enough to require more significant coverage. So it does, to some extent, depend on your stage of the life cycle, I suppose.

But from this, it would be very hard to argue that these response -- from these responses that the risk tolerance of the focus groups exceeded the 1:40 year standard.

What does the MCT -- next slide, please

-- what does the MCT say about risk tolerance? The 100 percent MCT implies a much higher risk tolerance standard than the 1:40 year standard of previous GRAs and technical conference discussions.

The 2015 DCAT, which -- where MPI proposed the 100 percent MCT for the upper threshold, was unable to determine the risk tolerance associated with this upper threshold, 100 percent MCT, using five thousand (5,000) simulations, since it did not produce a single case of a negative total equity balance, implying from this one (1) exercise that the 100 percent MCT criterion corresponded to a probability level of less than 1:5000 years, or .02 percent probability of an occurrence, far below the 2.5 percent or 1:40 year standard that had been employed in the DCAT and in previous discussions.

And this level of conservatism was rejected by the Board. One sixty-two sixteen (162/16) says:

> "The Board withdraws its support of the use of the MCT and a threshold MCT ratio of 10 percent -- of 100 percent. The Board is concerned that the degree of conservatism implied by the cor -- cor --

Corporation's proposal may be excessive based on the Corporation's scenario testing at the more extreme percentile levels of possible outcomes."

Next slide, please.

So what, then, does MC -- MPI do with the 40 percent -- the 1:40 year standard, the 2.5 percent standard? Well, it jettisons it. Without consultation with stakeholders, MPI announced that going forward, the chief actuary will select assumptions that more closely align with the risk appetite of the MPI board of directors, including a 1:100 year ninety-ninth (99th) percentile outcome.

And in response to CAC-MPI-1-15(a), they clarified that the 1:100 year risk tolerance is more closely aligned with the 100 percent MCT criterion for capital targeting.

What is some -- somewhat troublesome here is that the risk appetite of motorists has now been replaced by the risk appetite of the MPI board of directors. At a much more conservative level, it justifies higher premium for motists (sic) and a higher RSR and invites the question, really, rate stabilization for whom?

What are the risk premiums -- what are the premium risk to motorists beyond the adverse scenarios quantified in various DCAT reports over the past decade? I see no evidence in the DCAT reports that risks are increasing over time. The risks have changed through time. They've moved from the equity scenario -- the stock market collapse scenario, if you will -- to the interest rate forecasting scenario, to the claims scenario. These have all been well identified, well analysed. But they don't indicate increasing risk; in fact, to some extent, I think they indicate the opposite.

At the end of the GRA, there's a risk management framework section, which lists the top eleven (11) risks to MPI as determined by the enterprise risk management committee, but only two (2) of those are quantified using the DCAT methodology. So the retention of the DCAT insofar as is allowed to assess risk is really allowed only for about 20 percent of the cases that they've identified. The other are used -- they use alternative, non-quanti -- non-empirical methods.

So conclusions -- we have three (3) conclusions and a recommendation. The proposed rate setting procedure through the capital management plan with 100 percent MCT represents a significant change in procedure to establish target capital for Basic insurance and the risk stabiliza -- and the rate stabilization reserve, since the procedure has relied on -- on the percentage of premiums and DCAT methodologies to set the target capital range, not a level, up until now.

The proposed rate setting procedure under the -- the CMP with 100 percent MCT capital target level also represents a significant increase in the level of risk against which MPI ratepayers will be protected without new evidence of increasing downside risk to MPI and to rates. Holding capital at the 100 percent MCT level has no basis in the DCAT modelling completed by the Corporation and would lead to excessive levels of capital held. Next slide.

Recommendation -- the rate setting procedure should continue to use the DCAT results with a 1:40 adverse scenario as the benchmark -- I've put in brackets here a -- a range midpoint, if you will, because I think it should be a range as well as a target -- to determine the target range for the RSR.

DR. BYRON WILLIAMS: Thank you, Dr. Simpson. And -- my apologies. Thank you, Dr. Simpson, and thank you, Cheryl. We'll now turn to you, Mr. Todd.

MR. JOHN TODD: Quick leaner. I got it first try -- the mic. The other slide deck is just coming up. Cover page, which doesn't require any comments except good to be back before the Manitoba Public Utility (sic) Board.

As stated in the evidence at page 1, the evidence addresses MPI's capital market -- market -- capital management plan with a view to regulatory principles as they relate to Crown monopolies, which also operate unregulated lines of business, i.e., MPI. For today, I've structured these recapping comments as five (5) questions, as shown on the slides. Next slide, please.

So the first question is, is MPI a regulated public utility? As I sat down here just before our session began and looked up the password for the Wi-Fi, which is Public Utilities, I thought it's pretty obvious we're here because you regulate public utilities, and that sort of implies that MPI is probably a public utility.

So to me, both the answer to that question and the implications of the question are obvious. There may be legal debate that is beyond the scope of my expertise, so I'm addressing it strictly as a regulatory expert.

From the perspective of my work in the field of economic regulation, regulation is adopted when it's needed. Rate setting is adopted when the company, utility, has monopoly power. Most public utilities, as we generally conceive of them, are natural monopolies. They have facilities where it's not economic to have competitors within the marketplace. That's true of distribution of electricity, distribution of natural gas -- other areas that this Board regulates.

In those cases, regulation's adopted simply because it's needed. Rate setting is adopted when a company has monopoly power. The purposes -- the purpose is to protect the customers, and it serves as a substitute for competition. In the absence of competition, some alternative rate setting process is needed; otherwise, the company can set what I refer to as monopoly rates, which overcharge customers.

That simple concept is the basis of the field of public utility rate making. So my evidence looks at monopolies, they're regulated. It is the same for both natural monopolies and legislated monopolies.

And I just point out that over the last

hundred (100) years, airlines, railways, trucking, electricity generation, natural gas production were all at one (1) point in time legislated monopolies. And when you look at the literature over the past hundred (100) years or even over the last forty (40) years since I've been involved in the area, the same rate setting principles have been applied to all of these utilities, whether they were legislated monopolies or mono -- or natural monopolies.

So I see no difference in terms of the rate setting principles or practices to be different between legislated and natural monopolies. Again, my evidence sets aside the legal issues.

So what are the guiding principles for utility rate making? Very often, when I do evidence, I start by making reference to Bonbright's ten (10) attributes of a sound rate structure. I have included, at the back of this deck, several slides which reproduce those ten (10) principles. I thought it might be useful to have those for easy reference because they are such fendemen -- fun -- such a fundamental starting point for the way we think about setting rates for public utilities.

Regulators such as yourselves are focussed on identifying what's often referred to as just and reasonable rates for monopoly services. In simplest terms, the purpose is to set rates that recover prudently incurred costs. Those prudently incurred costs are fully recovered but are not to be over-recovered.

This implies, in the MPI context, that rates should be sufficient to achieve the required reserves but not more than sufficient. Those rates, then, are recovering costs from customers and through a cost allocation process, which you're familiar with, they're recovering them from cust -- customers -- different categories of customers based on who causes them. That's the basis of cost -- cost allocation. Again, that's not part of my mandate in this proceeding. That's part of the fundamental overall concept of utility rate-making.

Given the way the attributes of a sound rate structure have been approached, its fundamentals for monopoly pricing, those principles do not directly apply to competitive services, because you don't set those rates. It is assumed normally that a service that a utility offers that is not regulated because it's in a competitive market has a rate that's set by market forces, i.e., it is assumed that the utility is charging the competitive price for its competitive services.

So that means that the concern for regulators is the fair treatment and pricing of the utility services as it interplays with revenues that are generated by the competitive services. We can't apply those principles directly. We can only sure -- ensure that -- or -- or seek to ensure that customers of the monopoly services are fairly treated. Next slide, please.

So what's the standard regulator treatment of competitive services offered by a utility? For this, I'm looking across sectors. Most of the experience in utility rate setting, including the treatment of utilities that are also offering competitive services, comes from other sectors of the economy, nowadays, primarily electricity and natural gas.

And frankly, I struggled with this in terms of starting point a bit, because subsidy is at the core. So standard treatment reflects two (2) primary concerns by any regulator. The utility ratepayers should not be subsidizing competitive services. That's universal and accepted.

The MPI Act, Section 603, which is shown on the next slide, we'll come to it in a moment, explicitly addresses that question. When you look across the way regulators actually approach this issue, the concept of a subsidy is not consistently defined. It may include any benefit that provides a competitive advantage through shared services, cost savings, through providing access to customer information, through customer convenience. Anything that affects the competitive position of the competitive services can be viewed as a subsidy. That's not universal, but that's why some regulators do it.

And certainly, utilities should not be engaged in any competitive behaviour, not only from a Competition Act perspective, but that's the usual regulatory perspective. Part of what they're doing is in some cases, very explicitly ensuring that the competitive services do not disrupt the competitive market. In other cases, they're not, shall we say, protecting the competitive market, but they're looking for the competitive services to be part of the competitive market.

Part of that means that to the extent that the competitive services gain benefits from utility services, they should be fully compensated. Those benefits would not exist and be realized by the competitive service if it weren't for the monopoly service.

So most regulators say those benefits flow from the monopoly customers and therefore the value of those benefits would flow back to them. This statement assumes that the goal is to benefit monopoly customers. The goal of having competitive services is to benefit monopoly customers, not to benefit the Utility, and not to benefit the customers of the competitive services.

I said I had some difficulty here, because I think there are cases that undermined that concept, which says that all the benefit should -- should flow to Utility, or monopoly customers. It is possible that as a matter of public policy, there could be a direction to say what we want to do is keep rates below market rates for both monopoly customers and for competitive customers. That cannot be ruled out. That's a possible public policy position.

My view is that if you put it in the context of MPI, or we put it in the context of other companies that have -- that have monopolies providing competitive services, if the goal is to, in essence, provide discounted competitive services, as a regulator person, I don't understand why they aren't regulated as well.

The fact they are defined as competitive services to me means the intent is they should be priced like competitive services, and they should be sold at a competitive price. They should not be discounted.

If they are to be discounted, then that means there would be a regulatory role in deciding whether that discount should be 2 percent, or 5 percent, or 10 percent. In other words, those competitive services should be redefined as at least regulated services, even if not mandated. And the -- the regulator would have a role in making the decision of how much should those competitive services be discounted.

Therefore, from my perspective, the fact that there is no role of the PUB in regulating the rates of competitive services says to me the intent is to have competitive services offered at competitive prices, and the benefits that come from joint operations should flow to Basic customers. Next slide, please.

BOARD MEMBER GABOR: Sorry, Mr. Todd, I -- I just --

MR. JOHN TODD: Yes.

BOARD MEMBER GABOR: -- missed -- I just missed the last words you said. You said, And they should flow to --

MR. JOHN TODD: That the -- that the pricing should be at a competitive level, and the benefits that are derived from joint operations, i.e., they're probably more profitable because of that than if you were truly separate. Those benefits would flow back to the Basic customers, i.e., the monopoly customers.

(BRIEF PAUSE)

MR. JOHN TODD: Slide 6.

CONTINUED BY DR. BYRON WILLIAMS:

DR. BYRON WILLIAMS: And -- and Mr. Todd, we can hear you, but I'll just -- in -- there is a bit of background noise, so I'll just encourage you to -- to speak up a little bit if -- if you're able to.

MR. JOHN TODD: Okay.

(BRIEF PAUSE)

MR. JOHN TODD: So I just -- as I alluded to in the last slide, here is Section 6.3 of the Manitoba Public Insurance Act. It makes reference to:

> "The Corporation must ensure that the revenue from its plans of universal compulsory automobile insurance, Basic, and other revenues are not used to subsidize the Corporation's plans of Extension insurance."

So a classic regulatory concern is the regulated monopoly should not be subsidizing competitive services. That's clearly set out in the Act.

But how broadly should subsidy -- should that subsidize be defined? A very narrow view would be Basic insurance should not incur any avoidable costs. Clearly, if Basic insurance were incurring costs that it's not recovering through competitive rates, that would be a subsidy, no question about it.

A broader view that I've alluded to is maintaining a level playing field. In other words, whatever benefits the competitive services received by being for the joint operations should benefit utility ratepayers. Sometimes consumer advocates say we're the ones who are paying for the Basic function of the organization. If there's -- if they leverage off the -- that to have profitable competitive services, we should be paid the full amount of those benefits. Next slide, please.

So what are the primary models for the treatment of competitive services? A very common approach, particularly where there is -- really is a competitive market, is to have mandatory separation. In other words, the company is told, You as a regulated utility cannot offer competitive services. If you are going to do it, you have to create a parent company that sets up an affiliate, and that independent affiliate can offer those competitive services.

When that is done. There are strict transfer pricing rules that are put in place to prevent any cross-subsidization. In my evidence, I have a description of the affiliate relationship code of the Ontario Energy Board. That is probably the most well laid out example of how regulators can achieve this mandatory separation which ensures that there's no cross subsidy, and there's no pref --

preferential treatment. There's no advantage being given to the competitive side of the business by the regulators -- or utilities side of the business.

Part of that is limiting access to confidential -- confidential information, call centres can't refer people to the affiliate, things like that. So the affiliate operates in exactly the same position as any other competitive company. It has no advantages.

The second option is that a service can be offered by the monopoly, but it is defined as a nonutility service. In other words, the rate is not set -- set, not reviewed, not approved by the regulator. The Company is expected, but there's no mechanism to review and ensure, that the Company is expected to be going out and charging competitive price to run that business of the nonutility service.

When that is done, the typical approach is that the revenues and costs of that nonutility service are included in the revenue requirement of the Company of the Utility. And the -- the revenue requirement that is recovered from monopoly customers takes into account those costs and revenues, and the consequence of that is that 100 percent of the net profit, i.e., all the -- as Con (phonetic) used to call it, profit or excess profits, all of those are flowing back to reduce the revenue requirement, i.e., the rates for -- for monopoly customers.

So excess profits in excess of prudent cost recovery, which includes normal ROE, which is what I mean by -- what economists mean by profit, is used to reduce utility rates.

It can be very hard to measure these things. And so that nonutility service typically is only used in situations where there actually is not a workable -- workably competitive market. So we see it in things like hot water, natural gas hot water heating, or electricity water heating, where the Utility may be out there working with a -- contractors to provide hot water tanks to customers.

In some cases where that business has been around for a long time, regulators such as the Ontario Energy Board has required utilities to sell and separate off that business from their main function. Historically, if you look across the country where hot water tanks were brought in, particularly around natural gas, the purpose of it was to grow the natural gas business, and it was done in order to get larger flows of natural gas, bring down the cost of the utility service, the monopoly service by increasing the use of natural gas.

So is the reason for the competitive service being there was to lower costs and create benefits for the monopoly customers in the first place? Where there is a working competitive market, there's a tendency for competitors to complain about anti-competitive activities of the Utility offering competitive services, and that's where the easy solution is simply to say, well, you've got to stop providing that competitive service in the marketplace. Next slide, please.

(BRIEF PAUSE)

MR. JOHN TODD: So how can this standard treatment, which we see primarily in other sectors -- other utility sectors, how can this standard treatment of nonutility service revenue be applied to MPI? Well, I would carefully say in theory, you could compensate Basic for all the services and support using a fair market value. In other words, the competitive services would pay a fee for the benefits.

What's the value of the benefit of appearing on the same work forum? I think you were

going through some of that this morning and -- for --
for Basic and competitive services. What's the value
of that? What should the payment be? For all the
other conveniences, what should the payment be?

That would be almost impossible to determine unless you were to say, MPI cannot provide those services. MPI is going to make that package of collaboration, if you want, available to market, and we're going to put it out to tender, and whoever bids the most for the right to offer those competitive services will be our partner. That would be a market-determined value of that package of services.

My wording here is, In theory compensate, because I don't see a practical way to come up with a calculated value of the benefits that comp -- competitive services derive from monopoly services.

So in practice, and this is what we see from the mechanism that is normally done of including revenues and costs in the revenue requirement of the utility, the standard practice to treat excess revenues of Extension and SRE as the value of the benefits derived from the joint operations with Basic.

The concept there is if we decide -- as we define excess revenue, that is, any revenue in excess of what's required -- required to achieve a -- whatever the Board decides is the appropriate reserve structure, if you're generating revenues in excess of what's needed for that, this concept says the only reason they can get excess revenues is because they're benefitting from being associated with Basic. And that excess revenue becomes the way you define the benefit of the joint operation of competitive and Basic services.

And again, without the benefit, competitive pricing would not result in excess benefits. Therefore -- the logic says, therefore, excess earnings are a direct consequence of this relationship. Therefore, they should accrue back to Basic customers. Next slide -- slide is the conclusions.

So the implications of these comments for MPI's Capital Management Plan, which is what ultimately the evidence is all about, to reflect standard utility rate-setting practices, number 1, recognize the benefit that Extension and SRE derive from Basic has legitimate value for Basic to recover. Say that value is created by the relationship with Basic. Therefore, it's legitimate for that value to go back to Basic.

Second, it follows that you would limit the capital target for Extension and SRE to a level that reflects sound act -- actuarial practices -- not my expertise; that's the other evidence before you -- consistent with Basic. So the competitive services won't retain the benefit of the joint operations as a subsidy from Basic, but rather would flow it back to the benefit of Basic.

So to do that, you'd have to establish capital transfers rules that flow the excess Extension and SRE reserves back to Basic systematically, and number 1, you define what is that reserve. Number 2, whatever's excess would be flowed back to Basic systematically.

I think the MPI evidence speaks to what I would be saying is systematically, to avoid rate shock. It doesn't mean you necessary flow it all back on a year-by-year basis, but in some systematic way to avoid unstable rates. But it would recognize the excess revenues, or excess reserves would be recognized as something that should be -- flow as a benefit back to Basic customers.

And part of that would be to establish capital build and release provisions to return the excess Basic capital to customers systematically, again, in a way that is systematically doesn't mean it's something that's going to cause rate instability, but something which is going to recognize that these dollars should be benefitting Basic customers and therefore should be used over the long term, at least a multiyear period, probably, in order to keep rates down, or as a -- as an alternative to keeping rates down, as a lump-sum rebate to customers.

A lump-sum rebate concept is what economists love, because it lets you keep the price signal on the premiums for insurance at a cost base level that reflects the risks. And a one (1) time annual rebate would -- could be designed in a way that doesn't skew the -- that pricing.

The remainder of the slides that I mentioned are just the reproduction of the attributes of a sound rate structure for Bonbright, which is broadly recognized as the foundational principles for public -- for public utility rates. Many regulators have cited these, and have often restated them in their own way as -- as four (4), or six (6), or ten (10) principles, but the basic concepts are always the same. Those my comments.

DR. BYRON WILLIAMS: Okay. Thank you, Ms. Sherry, Dr. Simpson, and Mr. Todd.

Madam Chair, the -- though -- that concludes the direct evidence of our clients, the independent witnesses retained on their behalf.

They're ready for cross-examination, but just logistically, it's been about an hour. I wonder if my witness -- our witnesses might have a -- a break -- break, a five (5) to ten (10) minute break, just to stretch their legs and meet other necessities, and then be -- resume after that?

THE CHAIRPERSON: Sure. That's great. We'll take a ten (10) minute break, so we'll be back at 2:16, please.

--- Upon recessing at 2:07 p.m.

--- Upon resuming at 2:22 p.m.

THE CHAIRPERSON: Thank you, everyone. It is now MPI's opportunity for cross-examination. Mr. Scarfone?

MR. STEVEN SCARFONE: Thank you, Madam Chair. Again, just before we begin, some further exhibits to file, if you don't mind: seventy-four (74) to eighty-three (83). So if you had the over at a hundred (100), you're looking good. Exhibit No. 74 -- all right. Just a moment. MPI Exhibit No. 74 is the revised version of CMMG-1-19. That's an Information Request that was responded to by the motorcycle group.

--- EXHIBIT NO. MPI-74: Revised version of CMMG-1-19

MR. STEVEN SCARFONE: MPI Exhibit No. 75 is a response to Undertaking No. 7 and Appendix 1

--- EXHIBIT NO. MPI-75: Response to Undertaking 7

MR. STEVEN SCARFONE: Exhibit No. 76 for MPIC is a response to Undertaking No. 10.

--- EXHIBIT NO. MPI-76: Response to Undertaking 10.

MR. STEVEN SCARFONE: Exhibit No. 77, a response to Undertaking No. 12.

--- EXHIBIT NO. MPI-77: Response to Undertaking 12

MR. STEVEN SCARFONE: And I see here that Appendix 1 will be on the FTP site.

Oh, I see. It's a very large document,

so it's going to be circulated electronically.

Exhibit No. 78 is a response to Undertaking No. 23.

--- EXHIBIT NO. MPI-78: Response to Undertaking 23

MR. STEVEN SCARFONE: MPI Exhibit No. 79, a response to Undertaking No. 25.

--- EXHIBIT NO. MPI-79: Response to Undertaking 25

MR. STEVEN SCARFONE: MPI Exhibit No. 80 is a response to Undertaking No. 28.

--- EXHIBIT NO. MPI-80: Response to Undertaking 28

MR. STEVEN SCARFONE: MPI Exhibit No. 81 is a response to Undertaking No. 29.

--- EXHIBIT NO. MPI-81: Response to Undertaking 29

MR. STEVEN SCARFONE: MPI Exhibit No. 82 is a response to Undertaking No. 30 and Appendix 1.

--- EXHIBIT NO. MPI-82: Response to Undertaking 30

MR. STEVEN SCARFONE: And lastly, MPI Exhibit No. 83 is a response to Undertaking No. 31 and Attachment A.

--- EXHIBIT NO. MPI-83: Response to Undertaking 31

MR. STEVEN SCARFONE: And -- that -- that's an update on the MPI exhibits, Madam Chair.

DR. BYRON WILLIAMS: Madam Chair, if I -- I might. With regard to MPI Exhibit 74, which was characterized as an update to CMMG-1-19, our client would wonder whether it's really an update to CMMG-1-19 or additional calculations performed by Manitoba Public Insurance that are not responsive, necessarily, to the original Information Request but employed as a -- a tool for cross-examination.

And that may, indeed, be the case. Our client would not -- well, we disagree with the characterization. If that's what it's being presented in, we'll accept that, but I -- I would note that our clients have not had an opportunity -- or, witnesses have not had an opportunity to review the calculations.

So our suggestion in terms of fair process would be that if Manitoba Public Insurance is introducing -- trying to introduce via our witnesses calculations, that they include the derivation of those calculations. Our -- our -- our witnesses, if they do intend to use it for cross-examination, would accept the numbers subject to check but would retain the right to do further calculations. That would be our client's position.

THE CHAIRPERSON: Thank you, Mr. Williams. Mr. Scarfone, do you have a response to that?

MR. STEVEN SCARFONE: I do. One (1), I think I -- I described the exhibit as a revised version of that particular Information Request, so it's not an updated version. It's a revised version. So My Learned Friend is correct that it does contain new information that the Corporation intends to make use of during the cross-examination.

So perhaps when -- when the document is before us, as My Learned Friend has said, if there's some numbers in there that any of the witnesses that don't understand or take issue with, they would be subject to check, as Mr. Williams has said, but also, if the Board is so inclined, could ask that we do provide those supporting numbers to show how the columns were arrived at.

DR. BYRON WILLIAMS: And Madam Chair, we don't wis -- wish to interfere with My Learned Friend's cross-examination, so just to be clear. We would request the -- the derivation of the new calculations and would reserve the right to provide additional comments from our witnesses afterwards if there's some -- some concern with the -- with the analysis.

THE CHAIRPERSON: Thank you. We'll proceed with the cross-examination then and deal with those issues should they arise.

MR. STEVEN SCARFONE: Thank you, Madam Chair.

So MPI is -- MPI intends to begin with Mr. Todd this afternoon, given that his evidence is fresh in everyone's mind.

Kristen, could you pull up Mr. Todd's paper that was filed as an exhibit in this proceeding. Thank you.

CROSS-EXAMINATION BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: Good afternoon, Mr. Todd. My name is Steve Scarfone. I'm counsel for MPIC, so I'll be asking you some questions today about your evidence before the break.

MR. JOHN TODD: Good afternoon.

MR. STEVEN SCARFONE: Good afternoon. So sir, firstly, your paper was dated September 20th, 2019, and I see on the first page, the introduction page, that you have in there -- if you can scroll down to about line 13 -- that you have in there, and I'm always pleased to see this because it's now part of the -- the civil rules, that it sets out what your duty is as an expert witness, correct?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And you understand, sir, that an expert witness means that you are allowed, as you just did, to provide opinion evidence to this tribunal, something that's normally not allowed unless you've first been qualified as an expert in a certain area. You know -- you understand that?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And that your duty as an expert witness is to provide fair and objective and non-partisan evidence?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: Related only to matters within your areas of expertise?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And you also understand, sir, that you're not here to advocate for or against any particular issue before the Board. You're not an advocate.

MR. JOHN TODD: Correct. I'm expressing my views.

MR. STEVEN SCARFONE: Yes. You have a -- what I would suggest is a general disinterest in the outcome of this hearing.

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: Your -- your role here, really, is to just provide that expert evidence that we spoke of to assist the Board in making its findings, correct?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: So you don't care, sir, if MPIC's capital management is approved by this Board.

MR. JOHN TODD: No. That's a matter of the Board's decision.

MR. STEVEN SCARFONE: Correct. And you don't care, similarly, if it's rejected.

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And you don't care, sir, if this Board was to hold a different view as to what amounts to excess capital than what your opinion on that subject might be, correct?

MR. JOHN TODD: Correct. I'm -- and I'm attempting to share my perspective from working with other types of utilities and trying as my best to apply it by analogy to MPI --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- what would be consistent. And I always say before regulators, I'm wrong, the Board's right, when a decision comes out.

MR. STEVEN SCARFONE: Very good. And I see from your paper, sir, that on that issue of capital, you're aware that there is a reserves regulation in place.

MR. JOHN TODD: I'm aware that there is a reserve regulation, that my understanding is -- is contested. But yes, I'm aware of -- I have reviewed and I fully understand the reserve regulation --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- which would make my evidence rather redundant.

MR. STEVEN SCARFONE: Yeah, and -- and so you've -- you've jumped -- see, I have a list of questions here. So the first one (1) was you're aware of the reserves regulation. Yes. And that there's a challenge to that regulation. You're aware of that.

MR. JOHN TODD: Correct. Yes. I'm aware of that.

MR. STEVEN SCARFONE: Yes. Sometimes I just -- I got to read from my script, and --

MR. JOHN TODD: Sorry. I'll -- I'll --

MR. STEVEN SCARFONE: I'll regroup.

MR. JOHN TODD: -- retract my answer and you can -- with your script. I'll give you wes -- yeses.

MR. STEVEN SCARFONE: And -- and to that end, sir, on that issue of giving evidence within your area of expertise, your paper candidly admits as much at the bottom of page 2. There's a sentence there that reads:

> "Furthermore, my comments set aside all legal issues related to the implications of the reserves regulation."

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: So I would suggest to you, sir, that you're not here today -- and you haven't suggested that you are -- to speak to the appropriateness of a regulation that provides for 100 percent MCT.

MR. JOHN TODD: I am agnostic on that question.

MR. STEVEN SCARFONE: And I -- similarly, whether that regulation was passed with the requisite authority under the MPIC Act.

MR. JOHN TODD: I'm agnostic, as I've absolutely no idea. That is a legal question.

MR. STEVEN SCARFONE: And I'll put a hypothetical to you, sir. If your paper was dated September 20th, 2019, instead of September -- or, sorry. If it was dated to September 20th, 2020, instead of this year, and if the validity of the regulation that sets out the MCT targets for the Corporation has withstood the challenge that's before this Board, you wouldn't look past or set aside those targets, correct?

MR. JOHN TODD: That would depend upon legal advice, which I would not provide. So I have been retained in situations where there was a regulation where -- I was retained by legal counsel whose position was that even though a regulation which applied to the company that was regulated was binding on the company, that that same regulation was not binding on the board itself because the board was following its legislation.

So it's complex legal issues, and if -- I would not be retained by a lawyer, if the lawyer's opinion was that from a legal perspective, anything I could say would be irrelevant.

MR. STEVEN SCARFONE: And so I agree with you on part of that response. There are a lot of complex issues at play when responding to my question.

MR. JOHN TODD: Yeah, and I -- I would need to have a legal opinion to answer your question properly.

MR. STEVEN SCARFONE: But the -- the essence of the question was if we were to all get into a time machine and it's a year from now and that regulation was upheld and found to be valid after this proceeding has long ended, you wouldn't look past or set aside those capital targets because it's the law, correct? Much like, sir, you may not like the speed limit, but you have to obey it.

DR. BYRON WILLIAMS: I think this question has been asked and answered. The witness indicated there -- there are two (2) separate questions: a) is it legally vi -- binding, and then secondly, is it valid -- sorry, is it lawful, and then secondly, is it binding on the rate -- on the rate setting approval process itself? I -- I'll leave the witness to answer, but I think that answer's already been given.

MR. JOHN TODD: My views from a -- as a regular expert would not change, but as a matter -- as a legal matter, my views may be -- may be completely irrelevant.

CONTINUED BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: And -- and that's exactly my point. You might disagree --

MR. JOHN TODD: I agree with that. Yes.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: Sir, I see from your paper as well -- and you canvassed this in your introductory comments -- or your -- the counsel for the CAC did -- you've had five (5) previous appearances before this Board for MPIC rate applications.

MR. JOHN TODD: I believe that's correct, yes.

MR. STEVEN SCARFONE: 1998, 1999, 2000, 2002, and the 2006 General Rate Application.

MR. JOHN TODD: Yes. As long as my CV's correct, that's correct.

MR. STEVEN SCARFONE: Yes. And so this being the 2020 general rate application, sir, the last time you were here, again, for MPIC purposes, was fourteen (14) years ago.

MR. JOHN TODD: Sounds correct. Thirteen (13) years ago. I guess Mr. -- Dr. Simpson's math is better than mine.

MR. STEVEN SCARFONE: No, he was here last for the 2006 GRA, which would have been in 2005.

MR. JOHN TODD: Two thousand and five (2005). Long time ago.

MR. STEVEN SCARFONE: Long time ago. That tripped me up as well. We're here on the 2020 GRA --

MR. JOHN TODD: Right.

MR. STEVEN SCARFONE: -- even though it's 2019.

MR. JOHN TODD: Right.

CONTINUED BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: So sir, you mentioned in your paper at page 2 the Kopstein report from 1998. And you're aware, sir, that Robert

Kopstein was a provincial court judge in Manitoba? Did you know that?

MR. JOHN TODD: I knew that when I read it twenty (20) years ago --

MR. STEVEN SCARFONE: Twenty (20) years ago.

MR. JOHN TODD: -- or whenever it was. Yes.

MR. STEVEN SCARFONE: And that was my next question, so I'm going to just jump past that on the script. You've read the report, sir?

MR. JOHN TODD: I have not freshened on it, but I read the report in -- for previous proceedings, yes.

MR. STEVEN SCARFONE: And you'll -- you're aware, sir, and you touch upon it in your paper that the Kopstein report speaks to a retained surplus, which is an amount over and above that required for breakeven rates. That was what the judge was espousing about, correct?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And that retained surplus from the Kopstein report as recommended was to be in the range of 10 percent to 20 percent.

MR. JOHN TODD: Of revenues, I believe, yes.

MR. STEVEN SCARFONE: A percentage of premiums?

MR. JOHN TODD: Premiums, yes.

MR. STEVEN SCARFONE: And this, as we've heard earlier from Dr. Simpson, is to protect the ratepayers from rate increases arising from unexpected events and losses, correct?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: Events such as a stock market crash, an unusually large hailstorm, or perhaps forecasted interest rates of large magnitude that have gone incorrectly?

MR. JOHN TODD: I'm not fresh enough on the Kopstein report to say exactly what was the intent of that report, but along those lines, I agree.

MR. STEVEN SCARFONE: And -- and -- and the point of it was, if you have a capital reserve and you have these unforseen events, you can draw from the reserve rather than ask the ratepayers for the money directly.

MR. JOHN TODD: Well, it's a wate -- it is a rate stabilization reserve, yes. And those are not uncommon across Canada in other jurisdictions with various utilities.

MR. STEVEN SCARFONE: And indeed, at MPI, it is known as the rate stabilization reserve.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And so I will ask -- and this is the exhibit, Madam Chair, that my friend alluded to -- Exhibit No. 74, Kristen, a revised version of CMMG-1-19.

DR. BYRON WILLIAMS: I'm going to ask Mr. Todd if he's familiar with this, the original Information Request, CMMG-1-19, or not. We don't want to obstruct your examination; it just may be more appropriate to put it to a different witness. But I'll just -- just ask if -- Mr. Todd, if you're familiar with that exhibit -- original Information Request.

MR. JOHN TODD: No, I'm not.

CONTINUED BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: And so -- and for the purposes of my questions, I don't -- I don't know if the witness's familiarity is -- is needed, but of course, he can disagree with me, because I can explain. There's only a couple columns -- that I think it'll become obvious what the exhibit is presenting.

So the first column, sir, on the left-hand side is -- is the fiscal year, and you see that?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And then if you go down, it begins at 2003/2004. It's hard to read on that screen. You see that? Line -- line number 3.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: So that reads 2003/2004, and it goes all the way down to the present at line 18, 2018 and 2019.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And then if you look to the right, you can skip past about ten (10) of those columns, and you'll see a column that reads PUB-approved SR -- RSR range. Do you see that?

MR. JOHN TODD: Sorry, which column is that?

MR. STEVEN SCARFONE: It reads PUB-approved RSR range.

MR. JOHN TODD: I see it, yes, on -- about two-thirds (2/3) of the way across.

MR. STEVEN SCARFONE: Yes, thank you. And so underneath that particular column, for each of the respective years, is the range that this Board ordered for capital within the rate stabilization reserve.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: Do you see that? So the first one (1) reads 50 to $80 million?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And it goes all the way down to last year, 140 million to 315 million. Do you see that?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: Okay. And then if you skip over two (2) columns, you'll see, firstly, a column that reads 10 percent of annual net premiums written.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: Yes. And 20 percent of annual net wri -- premiums written is beside that. Do you see that, sir?

MR. JOHN TODD: Yes, I do.

MR. STEVEN SCARFONE: Okay. And so I'm going to suggest to you, sir, that those are the -- the Kopstein upper and lower ranges, as you've described. The Kopstein report recommended a range of capital between 10 percent and 20 percent. Is that correct?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: Ideally, sitting at about 15 percent. Somewhere in the middle.

MR. JOHN TODD: It's the middle, yes.

MR. STEVEN SCARFONE: Yes. And if you look back to the PUB-approved RSR range column...

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: You'll see, sir, that, as I indicated earlier, it begins at 50 to $80 million.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And increases with every successive year. And if you go down about ten (10) lines, you'll see that one (1) year, this Board ordered 89 million to 178 million. Do you see that?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And I would suggest to you, sir, that until that year, we had a very kind of consistent increase in the targets. Would you agree with that?

MR. JOHN TODD: Subject to check, in high level, it looks fairly consistent, yes.

MR. STEVEN SCARFONE: And then the following year, being 2015/2016, we see that there was a dramatic or a significant change to the targets. Would you agree with that?

MR. JOHN TODD: So going from the eighty-nine (89) at the lower end to two hundred and thirty-one (231) at the lower end.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: Would you agree that represents a significant change in capital?

MR. JOHN TODD: Significant change in the approved capital range, yes.

MR. STEVEN SCARFONE: Yes. And I'm going to suggest to you, sir, that the use of the dynamic capital adequacy test -- are you familiar with that -- that test?

MR. JOHN TODD: In terms of reviewing the evidence, not -- not from a detailed perspective--

MR. STEVEN SCARFONE: You're not an actuary.

MR. JOHN TODD: -- that's the subject of another -- yes, so I cannot speak to the content of it, but I understand basic -- basically the approach, yes.

MR. STEVEN SCARFONE: And I suggest to you, sir, and you have no reason to disagree, that

that's when the Corporation started using the DCAT for its capital targets.

MR. JOHN TODD: I don't know that as a fact, but I'll accept that.

MR. STEVEN SCARFONE: Okay. And prior to that, sir, it would appear that the Corporation was using the Kopstein percentage of premiums approach.

MR. JOHN TODD: I'll accept that.

MR. STEVEN SCARFONE: And I say that, sir, because if you look to the PUB-approved RSR range, just before the DCAT year -- so you'll see the eighty-nine (89) to one seventy-eight (178).

Do you see that?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: One seventy-eight (178) represents a doubling of the lower target.

MR. JOHN TODD: Sorry, the lower end of the target went from -- you're talking about the number went from eighty-nine (89) to two thirty-one (231)?

MR. STEVEN SCARFONE: Eighty-nine (89) to one seventy-eight (178) in the same year.

MR. JOHN TODD: Oh, the range.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: You're saying the

range --

MR. STEVEN SCARFONE: Right.

MR. JOHN TODD: -- was 100 percent range.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: Okay.

MR. STEVEN SCARFONE: And so that would represent a doubling of -- eighty-nine (89) times two (2) is one seventy-eight (178).

MR. JOHN TODD: The doubling -- the upper end is double the lower end.

MR. STEVEN SCARFONE: Yes. Yes.

MR. JOHN TODD: If that's what you mean by doubling, yes.

MR. STEVEN SCARFONE: So the 10 and 20 percent.

MR. JOHN TODD: Yeah. Well, not year to year, but within a range, yes.

MR. STEVEN SCARFONE: Yes. Yes.

MR. JOHN TODD: The range, yes.

DR. BYRON WILLIAMS: Ma -- Madam Chair, at this point in time, this is where the unfairness to the witness comes. I take it Manitoba Public Insurance is not suggesting that the 2015/16 year was the first year in which the dynamic capital adequacy testing analysis was undertaken by Manitoba Public Insurance.

MR. STEVEN SCARFONE: For the purposes of capital, not for satisfactory financial condition.

DR. BYRON WILLIAMS: So this is the -- the dual unfairness of this question. A witness who has not reviewed this IR, a witness who is not the preferred witness in terms of the dynamic capital adequacy testing or the MCT, who's not familiar with the history post. So -- and what is being undertaken here is, in terms of the analytical approach.

So if the questions are to be posed, they should be posed to the witnesses who have offered evidence on the dynamic capital adequacy and the MCT who are also familiar with the -- the fact that this testing was undertaken from many years prior to 2015/'16. So that is our objection.

And I will reiterate that from our client's perspective, the -- this goes to the unfairness that I flagged at the start in terms of the derivation of the analysis and the fact that it's not putting in the history of the dynamic capital adequacy testing since it was undertaken by MPI.

So that is our -- our concern. Wrong witness, unfair factual proposition, and not truly an updated CMMG-1-19.

THE CHAIRPERSON: Thank you, Mr. Williams. Yes. I agree that the witnesses who have offered testimony with regard to these issues are Dr. Simpson and Ms. Sherry.

I would ask that you proceed to direct your questions to them, and then we'll see further from -- from that whether there are continuing concerns about the derivation.

MR. STEVEN SCARFONE: And thank you, Madam Chair. So I may do that but not right now. So what I'd like to do is carry on with my cross-examination of Mr. Todd, and I may go back to -- to this exhibit with the other two (2) panel members.

THE CHAIRPERSON: That's fine. You're -- you're not anticipating asking Mr. Todd any further questions though with regard to this exhibit. Is that correct?

MR. STEVEN SCARFONE: No. Although I have to say, sir, you're doing a pretty good job following along, but I -- I will end that line of questioning.

THE CHAIRPERSON: Thank you.

MR. JOHN TODD: You're a very good conductor, so it's easy to follow along. All I have to do is say yes.

CONTINUED BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: So, sir, at page 4 of your paper.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: And -- and you know your paper, so I won't direct you right to it, but let me just ask you this question.

At page 4, sir, you say that one of the primary purposes of the rules in Ontario that govern the relationship between regulated entities like MPI and the unregulated or competitive lines of business offered by that same utility. So the utility in your paper is MPIC. Correct? That's the -- when you make reference to "utility," you mean MPIC?

MR. JOHN TODD: Mostly I'm making generic comments. So I'm just talking bout any regulated utility because the essence of my paper is talking at a level of principles --

MR. STEVEN SCARFONE: I see. Okay.

MR. JOHN TODD: -- and broad practices.

MR. STEVEN SCARFONE: In any event, you would say in your paper that the rules in Ontario are designed to preclude the subsidization of the competitive side by the regulated monopoly. Is that -- is that what the rules are or does the mischief that the -- the rules are designed to avoid?

MR. JOHN TODD: Sorry. Say that again?

MR. STEVEN SCARFONE: Yes. That the rules in Ontario that govern that relationship are designed to preclude the subsidization of the competitive side by the -- by the monopoly side.

MR. JOHN TODD: Yes. And I would clarify by saying subsidization in the -- what I've referred to as the broad concept --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- in my opening comments.

MR. STEVEN SCARFONE: Okay. And so in other words, I would say that there should be no money flowing from the Basic program into the competitive lines of business into Extension or SRE.

MR. JOHN TODD: That is one part of it.

MR. STEVEN SCARFONE: Part of it.

MR. JOHN TODD: But that's not what it's all about.

MR. STEVEN SCARFONE: No. But that's a bit part of it. You wouldn't want to see capital or any kind of net income flowing from Basic, the monopoly side, into the Extension side.

MR. JOHN TODD: That is the most extreme case of a subsidy, yes.

MR. STEVEN SCARFONE: Yes. But certainly, money flowing the other way -- so into Basic -- from the competitive lines of business wouldn't violate the provisions of the Ontario Energy Board's ARC or the affiliate relationship code.

(BRIEF PAUSE)

MR. JOHN TODD: If money were flowing into the regulated business -- this is -- and we're talking affiliates here -- into the -- from the affiliate to the regulated business and those dollars were used to reduce regulated rates, there would be nobody objecting to that.

MR. STEVEN SCARFONE: Yes. It seems to be on side --

MR. JOHN TODD: I have not seen -- I

have not seen it happen.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: I wouldn't expect to see it happen but nobody -- I can't imagine anybody objecting.

MR. STEVEN SCARFONE: It seems to be on side with the Ontario Energy Board's concerns.

MR. JOHN TODD: Absolute -- the -- and that -- broadly speaking, there's what's called the asymmetry rule --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- which is the flows are between affiliates and utilities are viewed in a -- in a asymmetric way, i.e., differently. That's part of the asymmetry rule, in essence.

MR. STEVEN SCARFONE: Okay. And by the way, I meant to ask you: So when you make reference to affiliate in -- in your paper -- and you touched upon this in your examination-in-chief -- are you speaking about an affiliate in the legal sense, meaning that it's a separate legal entity incorporated, files its own tax returns, that kind of affiliate?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And so that kind

of affiliate doesn't apply to Manitoba Public Insurance.

MR. JOHN TODD: No. And that's a point I make here --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- that that's -- Manitoba Public Insurance has competitive services that are what I'd normally define as non-utility services offered by the monopoly company --

MR. STEVEN SCARFONE: By the monopoly.

MR. JOHN TODD: -- as opposed to services being offered by a totally separate affiliate.

MR. STEVEN SCARFONE: Yes. And when you --

MR. JOHN TODD: And discussion of the affiliates is to provide an understanding of the thinking that goes into the treatment of competitive versus monopoly services.

MR. STEVEN SCARFONE: Right. And so those MPIC affiliates -- and I use that term loosely know, but I don't know what you would call them --

MR. JOHN TODD: Non-utility services.

MR. STEVEN SCARFONE: Non-utility services. Thank you. The MPIC non-utility services in your paper are the Extension line of business? Is that right?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And the special risk extension line of business.

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And so let me just ask you a couple of question about those two (2) lines of business, if I may. You're aware that the Extension line of business is for insurance products purchased by Basic customers.

MR. JOHN TODD: As I understand it, a core aspect is reducing the deductible for people --

MR. STEVEN SCARFONE: Yes. You got it. And increasing third-party liability?

MR. JOHN TODD: Yeah. And you -- you would not -- there'd -- there'd be no opportunity to buy those without first purchasing Basic. At the same time, there's no reason you couldn't buy those from some entity other than MPI except for the way the market's structured.

MR. STEVEN SCARFONE: That -- that's absolutely right. So -- but I just want to make sure you understand what we're talking about. So the Extension line of business is the products that the

Basic customers can buy in addition to their Basic mandatory coverage.

MR. JOHN TODD: Absolutely correct. And my understanding is that that has not changed in fourteen (14) years, so I'm not out of date --

MR. STEVEN SCARFONE: No.

MR. JOHN TODD: -- on that aspect of the business.

MR. STEVEN SCARFONE: You are not. And the -- so the other competitive line of business, as mentioned in your paper, is the SRE line of business -- the special risk extension

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And are you aware, sir, that that's a commercial insurance line?

MR. JOHN TODD: Well, if what you're talking about is individually underwritten -- if that's what you mean by -- by commercial? Yes, that's my understanding.

MR. STEVEN SCARFONE: And -- and I also mean by "commercial," it's -- it's commerce. And so it's the trucking industry. Were you aware of that?

MR. JOHN TODD: Which -- which are vehicles. Yes.

MR. STEVEN SCARFONE: Pardon me?

MR. JOHN TODD: Yeah. Which are vehicles but yes.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: So it's so separate. Yes. So my understanding is that SRE is not leveraged -- it's not interwoven, if you want, with Basic the same way as Extension is.

MR. STEVEN SCARFONE: Correct. So the customers of Basic, I would suggest, you are not purchasing any products offered by the special risk extension line of business.

MR. JOHN TODD: I haven't investigated that, but I -- if you say it, I'll accept it as an absolute as opposed to generally true.

MR. STEVEN SCARFONE: Okay. Thank you. So getting back to what you thought wouldn't raise a lot of concern from the Ontario regulatory and others if money was flowing from the competitive line of business into the monopoly business and used to reduce rates, that raises no concerns. Correct?

MR. JOHN TODD: Using that terminology, I'm going to refine that a bit.

MR. STEVEN SCARFONE: Okay.

MR. JOHN TODD: The flowing -- and

when we talked about it a moment ago -- was with respect to an affiliate, and yes, it wouldn't cause concerns.

If the flowing is from a non-utility service to a -- in effect to the utility services, not only would it be tolerated, but that would be the normal expectation. That's the way it is normally handled.

MR. STEVEN SCARFONE: That's the way it should happen.

MR. JOHN TODD: Well, I'm reluctant to use the word "should" 'cause it's a matter of public policy.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: But that is the way it is -- it normally does happen.

MR. STEVEN SCARFONE: And so, for example, we know from the evidence in this proceeding that MPI's Extension line of business -- so that's the business that you knew about, the one that sells lowered deductible, increases third-party liability -- we know, sir, that over the past three (3) or four (4) years, that Extension line of business has transferred $213 million into Basic with another sixty (60) million having recently been transferred.

So that transfer of capital, sir, is -- is kind of what the -- the regulatory in Ontario -- the Ontario Energy Board would like to see when you have these intertwined entities.

MR. JOHN TODD: I'm going to state your -- restate it more precisely. When you have a non-utility service, that is what the regulator in Ontario requires.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: And the requirement is that a hundred percent of the, if you want, excess profit -- that is a hundred percent above the actual direct costs which would include a normal approved return equity if there's -- if there's a capital investment involved, a hundred percent of that would be used to offset utility rates.

MR. STEVEN SCARFONE: To lower the rates of --

MR. JOHN TODD: To lower the rates for utility customers.

MR. STEVEN SCARFONE: -- of the monopoly provider.

MR. JOHN TODD: Exactly. To the customer -- monopoly customers.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: That -- that is -- that is the way the system operates.

MR. STEVEN SCARFONE: And, Kristen, if you could pull up the reserves regulation for me, please, and go to section 3.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: So this, sir, is a provision that -- as the title suggests is the use of surplus monies in the rate stabilization reserve. And when I say "rate stabilization reserve," I'm talking about the monopoly RSR -- Basics RSR.

And you'll see, sir, that it reads that:

> "The corporation may use amounts in the RSR that are in excess of the amount required under clause 2(a) for the purpose of reducing the rate indication required for Basic customers essentially."

Do you see that?

MR. JOHN TODD: Yeah. But I think a key word is the only but yes.

MR. STEVEN SCARFONE: Yes. And so

that, I think, you'd agree, sir, is consistent with what you say should be the case when there's these closely held or intertwined non-utility services and monopoly services.

MR. JOHN TODD: Yes. And the essence of my evidence is speaking to agreeing entirely with the direction, and I'm setting out principles for determining the amount.

MR. STEVEN SCARFONE: Yes. And -- and we'll leave the amount alone for now --

MR. JOHN TODD: Yeah.

MR. STEVEN SCARFONE: -- because the appropriate -- appropriateness of the amount is still very much at issue. But -- but the -- but I think I got a yes to, this is what the OEB would contemplate.

MR. JOHN TODD: Yes. Those reserves that are in excess of costs -- we'll put it that way, right?

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- would only be used for reducing monopoly rates.

MR. STEVEN SCARFONE: And then the cross subsidization that's in your paper can also be more discrete than the direct transfer of capital. Correct? It could include, as your paper sets out, the provision of services at a discounted rate or at an inflated rate, depending on which way you're going. And that's -- that's another mischief that the regulator has to guard against.

MR. JOHN TODD: Yes. So that's most meaningful in the context of an affiliate where there actually is transfer pricing where you have a non-utility services, the operations are often not so separate that there's actually transfer pricing involved. But the -- but the underlying concept is -- is the same.

MR. STEVEN SCARFONE: The provision of services at discounted rates --

MR. JOHN TODD: Provision of services that -- you've got to be recovering from the competitive side. The competitive side has to be paying for itself.

MR. STEVEN SCARFONE: Yes. So standalone principle.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: Well, actually standalone principle is a bit different because the standalone principle usually does a -- a determination of the cost of that business on a standalone basis.

What we're talking about with a non-utility service is actually what are the costs incurred which may be a lot less than the standalone costs.

MR. STEVEN SCARFONE: I see. And so allocating costs in a manner that, as you say in your paper, disadvantages the regulated business is another discrete method of cross subsidization.

MR. JOHN TODD: That is a potential method of cross subsidization that is precluded. Yes.

MR. STEVEN SCARFONE: But as you note in your paper, sir, at page 6, section 6.3 of the MPIC Act seems to address this concern.

MR. JOHN TODD: I agree.

MR. STEVEN SCARFONE: Yes. And -- and more to the point, this Board, after some reservation about excess retained earnings from Extension and SRE being available for non-insurance use back in the day, they approved a cost allocation methodology now in place for rate setting purposes. Agreed?

MR. JOHN TODD: Yes. And the cost allocation methodology, which I have not reviewed, assuming it is done correctly, ensures that -- or provides a measure to ensure that the competitive lines of business are at least paying their way.

MR. STEVEN SCARFONE: So that's --

that is the cross subsidization concern raised in your paper. And so --

MR. JOHN TODD: I wouldn't say that.

MR. STEVEN SCARFONE: No. But part of it is the --

MR. JOHN TODD: Part -- it's part of it, yes.

MR. STEVEN SCARFONE: Yes. Part of it is the guarding against monies flowing the wrong way?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: That's simplifying it, but that's one of the concerns. And the other one is the allocation of costs has to be addressed in a meaningful way.

MR. JOHN TODD: Yes. And that's part of it. But, I mean, the other part of it is the recognition of the benefits and of the joint operations which become dollars of profit in the competitive side and how are those treated. That's really the nub of the issue.

MR. STEVEN SCARFONE: Yes. And how --

MR. JOHN TODD: The others are so obvious that they're -- they just -- because they're so transparent.

MR. STEVEN SCARFONE: Right. And --

and the "nub," as you say, is -- you know, we really have to see some benefit being realized by the ratepayers of the monopoly.

MR. JOHN TODD: Well, I wouldn't say "some benefit." So firstly, you quantify the benefit that is being realized by the competitive side. And then the normal practice is that the full amount of that benefit through some mechanism flows back to the monopoly customers.

Or if you do not flow at all back to the customers on a timely basis, there would be usually a policy reason for not doing that. Sorry. Not an insurance policy reason but a public policy reason.

MR. STEVEN SCARFONE: So if I can paraphrase then, absent a policy reason, you would say not part of it -- the entirety of the benefits realized on the competitive side should be realized by the customers of -- on the monopoly side.

MR. JOHN TODD: That is the standard practice.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: I -- again, I am reluctant to use the word "should" 'cause there's a value judgment there. And as you pointed out in my mandate at the beginning, I'm not -- trying not to apply value judgements. I'm trying to apply principles and -- and recognizing practices.

MR. STEVEN SCARFONE: I appreciate that. And then the -- the second objective of the rules in Ontario is to restrict anti-competitive activities. That's what you paper says. Correct?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: An example of that might be where the unregulated line of business -- so Extension -- has access to customer information -- or customers generally -- that it might not otherwise have of -- if it was a true standalone.

MR. JOHN TODD: Correct. And instead of saying standalone, we'll say, would not have if it were a truly independent competitive entity unless there are rules about access information.

And one of the treatments of this type of situation in certain circumstances it that all competitive entities have to have the same access to information. Customer information is usually restricted just for confidentiality reasons for both the affiliate and anybody else.

But there are some cases where kind of -- if the book is opened and everybody has access, that's not discriminatory. That's not anti-competitive.

MR. STEVEN SCARFONE: And -- and so we know the situation with MPIC, and so where rules, as you say in your paper, are not in place to limit this competitive advantage -- right? so the customer information sharing and that kind of thing -- the regulator, you would say, needs to see some benefit or -- you don't like the word "some" -- so a benefit being attributed to the regulated entity from the competitive line.

MR. JOHN TODD: Yes. The -- the presumption is -- and I haven't done the analysis to prove it one way or the other -- the presumption is that competitive -- the competitive services are benefitting from the close association.

In other words, there's a checkbox, as I understand it, or an easy opportunity to get MPI's Extension options. There's not a list of all of the competitive potential insurers. Anybody who wants to can come in and have themselves added to that list to create an evil -- equal playing field.

Presumably, that means more people opt for Extension from MPI, Basic behavioural economics -- my favourite topic in the last five (5) years would tell you that -- the opt. Opt out -- people don't opt out. Opt in -- people don't opt in. So people aren't going to opt out, so they're going to -- going to take it.

There is a value to that from a -- sort of a corporate financial return perspective. That value is a -- exists because of the Basic, and therefore, Basic have a standard practice. The view is, therefore, Basic should say we're creating that benefit for competitive.

We -- the monopoly side should be compensated fully for that, i.e., the gain you get comes back to us which then leaves a level playing field because it eliminates the financial benefit to the competitive side.

MR. STEVEN SCARFONE: Absolutely. And -- and that's -- so that, I think, is -- is a way of basically saying the Basic customers should get something in return for this -- for this competitive advantage.

MR. JOHN TODD: Yes. And that particular definition says they should -- you know, is based on the -- they should get a hundred percent of it, but as a policy, it -- it could be something other than the hundred percent.

MR. STEVEN SCARFONE: And so again, the transfers of capital that I mentioned earlier might be a good example of such a benefit, one that would reduce rates.

MR. JOHN TODD: Absolutely. But as I understand it, both from the past and -- and present, those transfers are not based on a systematic and analytic determination of how much the benefit it and portion of it should flow back.

It's a -- it's a discretionary approach which would not exist -- does not exist as a standard practice in other analogous situations.

MR. STEVEN SCARFONE: And again, you know, we're dealing with a hypothetical. But if this challenged to the reserves regulation is -- is dismissed and the regulation is upheld, then we do have, I would suggest, that certainty of the amount that needs to be realized -- the benefit that needs to be realized by the -- by the monopoly customers.

MR. JOHN TODD: If I understand the regulation correctly, it would define a level of reserves that would be -- based on my analytic framework, would be viewed as the non -- no excess profit level of reserves.

I don't think the regulation speaks to

what you do with anything above it 'cause you still, you know -- wherever you set the reserve level, DCAT, MCT -- 100 percent, 200 percent, 500 percent -- there's always the potential you're going to be above it.

So it's really the transfers that my evidence is more speaking to. I'm leaving it to the other experts to deal with the matter of what's the right cutoff for the appropriate level of reserves.

Once -- once you get the right cutoff when you're above that, what do you do with the excess. That's what my evidence speaks to.

MR. STEVEN SCARFONE: Yes. And so --

MR. JOHN TODD: I don't think -- tell me I'm wrong, but I don't think the reserve regulations speaks to that.

MR. STEVEN SCARFONE: No. So the reserves regulation -- and, you know, I'm no legal expert -- but the reserves regulation --

MR. JOHN TODD: You're just a lawyer, right? Lawyers that put me on this topic.

MR. STEVEN SCARFONE: -- sets out the targets but the capital management plan, which you've reviewed, sir. Correct?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: That's the mechanism, as I understand it, that would provide for the transfer and to occur if that excess is -- is met.

MR. JOHN TODD: Exactly. That's the capital management plan, not the reserve regulation.

MR. STEVEN SCARFONE: Yes. Yes.

MR. JOHN TODD: Right.

MR. STEVEN SCARFONE: Page 8 of your paper, sir.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: I'm looking at the third bullet that begins with the words "in other cases."

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: So it reads:

"In other cases, utilities are permitted to offer competitive services as well as the monopoly services, but the income and expenses related to the competitive operations are included in the revenue requirement that is used to set the rates for the regulated services."

So, in effect, it's the net income in excess of the allowed return on investment that's used to reduce rates. Correct? That's what -- that's what your paper is --

MR. JOHN TODD: Correct. And a perfect example of that is the treatment is export revenues for Manitoba Hydro. That's exactly the mechanism you use.

MR. STEVEN SCARFONE: And so does that statement take into account that has to be retained on the competitive side?

MR. JOHN TODD: By analogy, yes. In -- in my framework, a gas or electric utility is a capital intensive business, and they have a rate base which earns a return. And aside from the people costs, that's the cost that they're collecting in rates.

MPI has the people costs, the same as Manitoba Hydro or Centre Manitoba. It has -- then it has insurance which is not pipes and wires but is analogous to the capital -- that's -- that's the business that they operate.

And the reserves would be analogous to the weighted average cost of capital, if you want --

it's not the same as, but it's analogous to the weighted average cost of capital -- that Manitoba Hydro that Manitoba Hydro or -- well, any -- any electricity or natural gas utility would earn on its capital investment.

MR. STEVEN SCARFONE: And so you're not suggesting, I don't think, that he excess, whatever that might be or the -- or the retained earnings or the net income -- whatever you want to -- you're not suggesting that that transfer over to the monopoly side without leaving the competitive side properly capitalized.

Whatever that capital number might be -- and we can quarrel over that -- you have to leave enough money in the competitive side to have them properly capitalized.

MR. JOHN TODD: I agree. And the -- the Board will resolve the debate hopefully --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- about what the proper capital level is. Is it -- is it DCAT or MCT and so on?

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: Once that's -- that is resolved and the percentage, then there will be a reserve target which is recognized presumably for Extension similar to one being recognized for Basic.

Whatever level is recognized and accepted for Extension becomes the appropriate level of -- of reserves and subject to the rules for transfer -- which that's another question -- they would flow back to Basic only when they exceed the reserve -- appropriate reserve requirement.

MR. STEVEN SCARFONE: So let me jump ahead. Now I'm off script entirely, but I will move you to page --

MR. JOHN TODD: I've done my job then.

MR. STEVEN SCARFONE: -- well, I'll move you to page 10 at line 23 because that's what you're discussing here.

It reads:

"If the PUB directs MPIC to adopt a different basic RSR capital target --"

So something different than 100 percent MCT. Correct?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE:

"-- its decision will imply that the alternate target that is approved by

the PUB provides a more appropriate
level of protection for customers
against extraordinary rate increases
to the..."

So you see that there. So what -- if I'm understanding that correctly, sir, you -- you should say that ultimately if the PUB was to decide that the right amount or the appropriate amount of capital that needs to be held over the -- on the Extension side is lower than a hundred percent MCT, then it's that excess above whatever amount they determine that needs to be transferred for the benefit of Basic customers.

MR. JOHN TODD: Whatever they determine --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- is the Board's determination of what is the prudent level of reserves which is equivalent to determining what the allowed net income or reserves are for Manitoba Hydro. And yes. So that -- that becomes -- that becomes the number.

MR. STEVEN SCARFONE: That becomes the number.

MR. JOHN TODD: And we have a

regulatory regime where the regulator is responsible for reviewing an application. And, if you want overseeing on behalf of the customers, the decision's being made by MPIC and saying you got it right or you didn't get it right.

And if they say you didn't get it right, that becomes the constraint.

MR. STEVEN SCARFONE: So --

DR. BYRON WILLIAMS: Madam Chair, could -- could -- and I -- I realize you're off script, but just were you trying to determine Mr. Todd's opinion on the Basis RSR capital target or the -- the Extension?

MR. STEVEN SCARFONE: Oh, sorry. And -- and I noticed that during that response, Mr. Todd made reference to Manitoba Hydro. That was obviously meant to be Manitoba Public Insurance.

So, no, the -- the question is, as 23 says, for the Basic RSR.

DR. BYRON WILLIAMS: Okay, because --

BOARD MEMBER GABOR: I can interject--

DR. BYRON WILLIAMS: Yeah, because --

BOARD MEMBER GABOR: -- Mr. Williams. I had the same point. Your reference was to a hundred percent. And then you talked about Extension. And I didn't know if you were talking about a hundred percent for Basic or 200 percent for Extension.

You seem to the mix the two (2) of them --

MR. JOHN TODD: Yeah.

BOARD MEMBER GABOR: -- together, and -- and I didn't know if you -- you just misspoke or --

DR. BYRON WILLIAMS: And just to assist the discussion, if you're looking for an analogous opinion by Mr. Todd on Extension, I think it's page 13, lines 24 and on.

Just -- I didn't -- I don't want to interfere, but it was confusing to the record, I think, which you were referring to, sir.

CONTINUED BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: Okay. So, if I did confuse the Extension side with -- with the monopoly side, I apologize. But I am dealing on this line of questioning with the 100 percent MCT target for Basic that's currently codified in a regulation.

So, the question to you, sir, is, based on what you see here, if the PUB directs MPI to adopt a different RSR capital target, that would mean different than 100 percent MCT, correct?

MR. JOHN TODD: Well, first, because there is a contested regulation, there would have to be a resolution of the status of the regulation.

MR. STEVEN SCARFONE: Yes, I agree.

MR. JOHN TODD: And there would have to be a resolution of whether that regulation, if it is legal, is binding on this Board.

MR. STEVEN SCARFONE: Correct.

MR. JOHN TODD: So, I mean, there's lots of legal questions there.

MR. STEVEN SCARFONE: Leg --

MR. JOHN TODD: Assuming all of those things --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- and the Board is in a position to say, no, it shouldn't be a hundred percent, if you're using MCT, it should be 90 percent, if it's legal for the Board to make that decision, they make that decision, and that's what's binding.

MR. STEVEN SCARFONE: So len -- let me put this hypothetical to you. Assuming -- and it's an issue before this -- this panel

MR. JOHN TODD: M-hm.

MR. STEVEN SCARFONE: Assuming that the regulation is -- is determined to be valid --

MR. JOHN TODD: Okay.

MR. STEVEN SCARFONE: -- but the Board, in its discretion, chooses a different capital target for Basic, okay --

MR. JOHN TODD: Are you asking me a legal question?

MR. STEVEN SCARFONE: No, it's not a legal question. I want to know, based on what you've indicated there -- I would suggest to you that it puts the Corporation in a bit of a bind because they're now having to choose between following a regulation or following an order of this Board.

You can't have it both ways. There's a -- there's a valid regulation that says it's a hundred percent MCT, but you have a Board order that ways we think Basic capital levels should be something less than a hundred percent MCT.

MR. JOHN TODD: Well, if you, as I'm sure -- as I think you have reviewed my CV, you'll recognize that my God is the regulator; therefore, the regulator's decision is final.

MR. STEVEN SCARFONE: So --

MR. JOHN TODD: And in my world, it doesn't matter what the government says. And I've seen regulators that have made decisions that said the government has a policy, and unless they change our legislation as the regulator, which they can do --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: If they haven't done that and we are acting in accordance with our legislation, what we're doing is appropriate. So, now I'm kind of giving a legal opinion. You're the lawyer. Tell me I'm wrong.

MR. STEVEN SCARFONE: Oh, no, not -- not at all.

MR. JOHN TODD: But that's my understanding from the lawyers I work with. And -- and, yeah, the -- the Corporation may be in a bind, but that's --

MR. STEVEN SCARFONE: No, I --

MR. JOHN TODD: -- your problem.

MR. STEVEN SCARFONE: I was going to ask you. So, in -- in your view, that presents no real dilemma for MPIC in that scenario, in that hypothetical?

DR. BYRON WILLIAMS: That's beyond this witness's expertise. This witness is speaking to generally accepted regulatory principles. If MPI wants to provide evidence as to its dilemma, it's -- it's certainly welcome to do so.

THE CHAIRPERSON: Thank you, Mr. Williams. Yes, Mr. Scarfone, I think that you should --

MR. STEVEN SCARFONE: Oh, I had no -- I was letting that one (1) go.

THE CHAIRPERSON: You're letting it go.

MR. STEVEN SCARFONE: Yeah.

CONTINUED BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: Back to the script.

MR. JOHN TODD: Oh, we're having so much fun; it's too bad.

MR. STEVEN SCARFONE: Page 10, your first full paragraph.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: I just wanted some clarification about --

MR. JOHN TODD: Full paragraph starting, "While MPI does not face..."?

MR. STEVEN SCARFONE: I'm just going to get -- well, I do have a question in the partial paragraph. About three quarters of the way down it reads, "A capital structure that puts the utility at risk." Do you see that?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: What do you mean by those words, "A capital structure"?

(BRIEF PAUSE)

MR. JOHN TODD: I think you should interpret that as being the reserve ratio.

MR. STEVEN SCARFONE: Okay. So, that's not the capital management plan. That's just the --

MR. JOHN TODD: No. The capital management plan is more than that, yes.

MR. STEVEN SCARFONE: Yeah.

MR. JOHN TODD: It's just -- it's just that's the -- in effect, that's the target.

MR. STEVEN SCARFONE: That's what you're talking about there. So, that's --

MR. JOHN TODD: How much --

MR. STEVEN SCARFONE: -- you're -- the amount of capital that you hold?

MR. JOHN TODD: The amount of capital

that you hold in reserves, yes.

MR. STEVEN SCARFONE: Yeah. Thank you. And then, now we'll get to the first full paragraph on page 10. I'll give you a quick -- I'm not going to read it back to you. And you wrote it, so you're probably very familiar with the words.

But I just want to confirm for you, sir, that that whole paragraph, after reading it, is really just saying that Manitoba Public Insurance should have reserves in place. And you're not disagreeing that there should be reserves?

MR. JOHN TODD: I agree.

(BRIEF PAUSE)

MR. JOHN TODD: But, I mean, I -- of course, I'm not saying that as an expert in ins -- the insurance business. I'm saying that from my reading and use -- using analogies, that obviously that's what this business is all about.

So, again, that particular statement may be kind of outside my area of expertise.

MR. STEVEN SCARFONE: Right.

MR. JOHN TODD: But utility regulation will recognize the requirements. And that's no different than for a capital intensive utility. They have to earn a return on their capital investment, the same -- you know, by analogy, it's the -- it's the same concept, as far as I'm concerned.

MR. STEVEN SCARFONE: And I'm going to quarrel with you, I expect, on -- on some -- the -- the choice of words in your paper at line 17 on that same page.

The first sentence reads:

> "The implication of MPIC's evidence is that an RSR target for Basic insurance that is based on a hundred percent MCT is appropriate."

Do you see that?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And I'm going to suggest to you, sir, that it's more than an implication. It's -- it's set out in a regulation passed by cabinet. And that is what MPIC is relying upon for its 100 percent MCT target?

MR. JOHN TODD: I will accept that as MPIC's position, yes.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: We did look at the purpose of the rate stabilization reserve, and it's set out there at page 9 of your paper. Dr. Simpson read it, and so we won't read it again.

But you'll agree with me, sir, that the purpose essentially is to protect motorists from rate increases, or perhaps even rate shock?

MR. JOHN TODD: Yes. And to put it in my language, I would refer to those extra Bonbright slides attributes -- attributes of a sound structure, numbers 2 and 3, revenue stability and stability particularly rates. They're probably all talking about the same thing, so.

MR. STEVEN SCARFONE: Is that the 1998 paper of the Bonbright one?

MR. JOHN TODD: Yes, that's from his 1998 book --

MR. STEVEN SCARFONE: Okay.

MR. JOHN TODD: -- which is the Second Edition, which is up, yes. So, attributes 2 and 3 are principles that speak to exactly that point.

MR. STEVEN SCARFONE: And another purpose, I suppose, if you want to use that word, of the RSR is to provide stability, rate stability. Would you agree with that?

MR. JOHN TODD: Yes, and -- and bond rates number 3, stability and predictability of the rates themselves, yes.

MR. STEVEN SCARFONE: And I think you'd also agree that a depleted rate stabilization reserve is -- is not a good thing for ratepayers?

MR. JOHN TODD: Correct. And that links more to bond rates number 1, effectiveness in yielding total revenue requirements. So, we're -- we're totally aligned.

MR. STEVEN SCARFONE: We are aligned.

MR. JOHN TODD: I'm -- I'm saying that.

MR. STEVEN SCARFONE: We are very aligned.

MR. JOHN TODD: Where -- where I come from is no different than where we are in the MPI proceeding.

MR. STEVEN SCARFONE: Yes. And -- and so, the last part of that, and I think you'll agree with this, as well, is a depletion of a capital reserve, or the RSR, is more likely to occur if it holds less capital?

(BRIEF PAUSE)

MR. STEVEN SCARFONE: That's an easy one.

MR. JOHN TODD: Well, okay, I -- I will not -- I will not go with the yes but -- no, I actually will go with the yes but. Yes, and I'm linking those objectives to ten (10) principles which are not -- there's no hierarchy to them.

So, I'd say, yes, you balance those goals or those principles around yielding a full return, revenue stability, rate stability with the other seven (7) principles, which include principles around fairness to ratepayers and -- and other -- other aspects, so, yes, as long as you're putting it in the context of balancing act.

MR. STEVEN SCARFONE: Yes. And -- and so, having acknowledged that the depletion of the capital reserve is bad and it's more likely to occur if there's less capital in the reserve, it seems to me, sir, that -- well, let me just bring you right to it.

MR. JOHN TODD: So, okay. But I'm going -- I'm going to correct your wording, but go ahead.

MR. STEVEN SCARFONE: No, go ahead. I don't --

MR. JOHN TODD: Okay. So, depletion of the reserves is not bad, it's normal. What you need is a structure which accommodates the reality that there will be variances that will sometimes deplete the capital.

And as long as you've got a regime in place that can -- that's resilient to that, you're okay. So, it's not bad, it's normal.

MR. STEVEN SCARFONE: And, in fact, this Board is aware that the RSR has been depleted in years past. And that was why I had mentioned to your earlier about the $213 million in transfers. That was to build the RSR back up, the Basic RSR.

MR. JOHN TODD: Yes. So, there's -- there is a mechanism in place for dealing with that. That's normal course of business. That's to be expected. It's not something to create a rainy day fund that is so huge that it could never happen. And that was addressed by Mr. Simps -- Dr. Simpson.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: At page 10 on that same point, at the very bottom of page 10, line 26, thanks Kristen, it reads there:

"Presumably, the interests of Basic customers are best served by adopting the lowest Basic RSR target and, hence, the stable rates that would be both prudent given the risks inherent in MPIC Basic insurance business and the stated goals of the RSR."

Do you see that?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: So, I'm struggling to understand how the interests of Basic customers are best served by having the lowest RSR target one can have.

MR. JOHN TODD: When you stated a second time just now, you cut off the important part of the sentence.

MR. STEVEN SCARFONE: Which is?

MR. JOHN TODD: Which is:

"Prudent given the risks inherent in MPI's Basic insurance business and stated goals of the RSR."

MR. STEVEN SCARFONE: Okay. But we -- we -- we --

MR. JOHN TODD: It doesn't mean lower

-- it doesn't mean lower is better without regard to analysis.

MR. STEVEN SCARFONE: Okay. That's what I thought you were getting at.

MR. JOHN TODD: No, no, no. What I'm saying is, the analysis tells you how much is necessary. It's just the same as setting rates for any other kind of utility where the wording I like to use is the utility should be able to recover its full revenue requirement, all of it, but no more.

You don't set rates to over recover the prudently incurred costs. And by analogy, the prudently incurred costs here are the costs that are necessary to prudently run the insurance business, which includes an appropriate level of reserves.

MR. STEVEN SCARFONE: And again, we don't -- we won't go there because we know that that level is a live issue before this Board?

MR. JOHN TODD: Correct. And it's level -- and it's an -- an issue that I have not addressed.

MR. STEVEN SCARFONE: Yes.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: At page 12 of the paper, and -- and we're getting through it slowly but surely, lines 1 to 12, this touches upon a question I asked you earlier.

So, this can -- this paragraph or this -- these lines set out what I'll describe as -- as a formula that should be used -- an easy formula to use to make sure that the monopoly customers are getting the benefit of the Extension line, correct?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And so, if I understand -- I was never very good at math, but if I understand the accounting that you're recommending or that is recommended in the industry, is that -- and I'll use MPIC's businesses, Basic costs, so the costs to run the Basic program, plus the Extension line of business costs, and you get your total costs of those two (2) lines, minus the Extension revenue would equal Basic's revenue requirement?

MR. JOHN TODD: Conceptually, yes. And remember this discussion is conceptual in a generic way.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: That is explicitly the way it is done for most electricity and natural gas utilities, including here in Manitoba.

You take that concept and apply it to MPIC, it changes slightly in that we -- MPIC does not have a revenue requirement per se. It has costs and it has revenues to cover those costs. And Extension has costs.

And the bottom line is not net income, but really the -- the reserves, the reserve ratio.

MR. STEVEN SCARFONE: And that -- that's the --

MR. JOHN TODD: The cutoff.

MR. STEVEN SCARFONE: That's --

MR. JOHN TODD: So, anything that's above the cutoff --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- is accumulative because it's -- it's accumulative, not an individual year concept. It's accumulative net excess, if you want, that then is -- would be part of a transfer policy to say this would flow back to customers in appropriate way.

MR. STEVEN SCARFONE: And that's why I'd asked you that question earlier. So, it seems to suggest that, basically, all the profits from the Extension line go to the monopoly, but you do have to factor in and leave in some capital behind for the Extension line?

MR. JOHN TODD: Okay. For the sake of argument, let's assume that this board accepts the Company's position that a 200 percent MCT is the appropriate test for the prudent reserves for Extension.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: When you get to 210, that 10 percent would be available for transfer.

MR. STEVEN SCARFONE: And then is used to lower the rate indication?

MR. JOHN TODD: Well, as I mentioned in direct, it could be -- it's -- it would flow back to customers. There are different ways you could do that. One (1) -- one (1) way would be to reduce rates. Another way would be to provide a rebate.

MR. STEVEN SCARFONE: And another way might be to achieve a capital target that the monopoly might not be at?

MR. JOHN TODD: If the monopoly is below its target --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- that would probably be the first recourse, yes --

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: -- which is exactly consistent with MP --

MR. STEVEN SCARFONE: Yes. And that's what the capital management plan contemplates?

MR. JOHN TODD: Exactly.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: Exactly.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: Page 13, the second bullet.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE:

> "In cases where rigorous rules to limit anti-competitive activity have not been imposed -- and you say in brackets there -- (which appears to be the case for MPI's Extension line and SRE lines of business) the financial success of the non-utility lines of business may be reasonably attributed in whole or in part to the intertwining of the utility and

non-utility lines of business."

So, I'm going to suggest to you, sir, that -- and again, this is the -- the theme of your paper, that the monopoly side of things has to see some benefit from the competitive line of business, or all the benefit, in your view.

And -- and so where there isn't a rigorous rule in place to address that, that's what has to occur. I'm going to suggest to you that this Board approving the capital management plan would be such a rule.

That would be tantamount to a rigorous rule?

MR. JOHN TODD: I agree that the capital management plan sets out a mechanism for transfers. And what first -- what's important is that the target should be a target that is prudent for Extension and based on analysis, based on what are the risks and so on; it can't be arbitrary.

But I have not really criticized the capital management plan in terms of the transfers and so on; it envisages transfers. I have discomfort when it's characterized as discretionary or in some how a gesture generosity from -- when it ignores the fact that the excess exists because of the association with

Basic and, therefore, Basic has a -- shall we say, a legitimate claim on that is the way it is viewed in other jurisdictions where you have competitive services being offered and intertwined with a monopoly business.

MR. STEVEN SCARFONE: But, like, what you've said there, sir, is where that is your understanding, or if it appears as though it's being ignored, as you say in your words, there has to be some mechanism, some rule in place, to address that concern?

MR. JOHN TODD: And as long as the goal is clearly defined and the mechanism is consistent with that goal, what I -- then everything's fine.

And my main comment is, is the level proposed by MPIC, 200 percent MCT, is that put forward as a prudent and necessary level of reserves for that line of business.

MR. STEVEN SCARFONE: But you -- you have no specific knowledge as to what the appropriate level of the Extension line of business should be, correct?

MR. JOHN TODD: No. That is being addressed separately.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: And there's a complementarity between the ex -- different pieces of expert evidence, and that issue is left to other experts and, ultimately, to the Board.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: At page 15 of the paper, sir...

(BRIEF PAUSE)

MR. STEVEN SCARFONE: At line 3 it reads:

"It should be noted, however, that the stability objective may better be served if the RSR target is defined as a range rather than a point value."

Do you see that?

MR. JOHN TODD: Yes, I do.

MR. STEVEN SCARFONE: Last year in this proceeding, the 2019 General Rate application, this Board ordered capital targets based on the dynamic capital adequacy test, and it was -- $140 million was the lower target.

MR. JOHN TODD: Okay.

MR. STEVEN SCARFONE: And the upper target was $315 million.

MR. JOHN TODD: Okay.

MR. STEVEN SCARFONE: That was the range. We've heard evidence in this proceeding that the Corporation now is at or near 100 percent MCT. And the chief actuary said that that amount --

MR. JOHN TODD: So, the Corporation referring to Basic?

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: Sorry.

MR. JOHN TODD: So, separate the Corporation. Okay, not the Corporation then, but Basic?

MR. STEVEN SCARFONE: Basic. Yes, the Basic is at or near a hundred percent MCT. And -- and when Mr. Johnston testified, he's the Corporation's chief actuary, he said that amounts to about $375 million.

So, my -- my question to you, sir, is that comment at page 15 is really all relative because certainly capital at 375 million, although it's a point, as you described it, provides more rate stability than a range whose upper limit is three hundred and fifteen (315)?

MR. JOHN TODD: Okay. Let me clarify on sort of where I'm coming from in this paragraph. And all my comments are kind of coming from an analogy.

This Board would be familiar with the concept that, when you do cost allocation for Manitoba Hydro, you come up with revenue cost ratios for each rate class and, in setting rates, you set a range of the revenue cost ratio, not a -- you don't always adjust rates to be at exactly 100 percent revenue to cost ratio.

The purpose of that range is to facilitate rate stability. And so, I'm simply transferring it, saying, well, firstly, you got to get your number right and, secondly, you need a decision, which is judgment, on how much of a range will get the level of rate stability you want.

So, that requires something I have not done, which is to look historically at the level of volatility of -- of returns. And -- and the goal is that, when you get normal variances from forecast, that sort of self-correct, because you end up doing better than expected one (1) year, you do worse the next year, you're giving time for it to be self-correcting, so you don't have to change rates or do a rebate frequently because those variances you say will just come out of the wash.

What you're doing is saying, if our reserve ratio gets too low, you start getting at risk for the Company's financial position to be compromised or, if it gets too high, you're going to end up with huge refunds, so that's when you're getting outside the range of the normal variances from year to year.

One (1) of the things that Manitoba Hydro has done in the past is looked at multi-year variances, like, due to low water flows. The same thing here. The variance is something which needs to be -- or the range is something that needs to be determined by an analysis of normal variances.

MR. STEVEN SCARFONE: So, but -- so, I think you're still quarrelling with -- so, if the point value --

MR. JOHN TODD: M-hm.

MR. STEVEN SCARFONE: -- is higher than the upper end of the range, by its definition, it has to provide more stability and less volatility?

MR. JOHN TODD: I -- I don't follow that. The -- the breadth of the range is the only thing that determines the ability to be stable. And--

MR. STEVEN SCARFONE: If you have more --

MR. JOHN TODD: -- what you're say -- what you're -- what you're saying -- now, remember you're also balancing objectives. I -- from a -- from a lawyer's perspective, do the math, yes, if -- if you go to a thousand percent, you're never going to have a large rate increase because you're going to be -- so much is in the rainy day fund that you'll be able to sustain anything for ten (10) years.

But then you're compromising the other principles of rate setting by taking too many dollars from the customers, right. So, while there's sort of truth to that, you -- the way you ask the question says this is a good thing, as though there's no cost to it.

There's a cost to it. Customers are paying higher rates.

MR. STEVEN SCARFONE: Well, let me ask you this, sir, then. Are you suggesting that the other insurers in this country that have adopted the hundred percent MCT test have invited rate instability to their customers?

MR. JOHN TODD: You're talking about competitive insurances or you're talking about ICBC or others?

MR. STEVEN SCARFONE: Just any insurer that's adopted the point value system, the 100 percent MCT, they've -- they've done away with the range. And -- and the evidence, as I understand it, is that might introduce some rate instability.

DR. BYRON WILLIAMS: I'm not --

MR. STEVEN SCARFONE: The range is preferred?

DR. BYRON WILLIAMS: I'm not sure that our client would accept that factual premise. And certainly, with the MCT, for example, in a competitive market there might be a 150 thou -- or 150 percent base limit, and then others, so I'm not sure our client would accept...

Now, if Mr. -- if legal counsel for MPI wants to put that factual question -- analytic question to people who have more experience with the MCT, we're happy to allow that. And maybe I misunderstood the premise, but I would say that point -- I'm not sure our client would concede the factual basis for that premise.

MR. STEVEN SCARFONE: And -- and I think Mr. Williams is probably correct, madam chair, that the words 'rate' and 'stability' with the MCT test, I think those words came from Dr. Simpson, so perhaps it's better put to him after this cross-examination is done.

THE CHAIRPERSON: Yes, please do.

MR. JOHN TODD: Yeah. And my understanding is that the MCT as an acronym is minimum capital test --

CONTINUED BY MR. STEVEN SCARFONE:

MR. STEVEN SCARFONE: Correct.

MR. JOHN TODD: -- so I do not understand as a point forecast.

MR. STEVEN SCARFONE: You don't understand whose point?

MR. JOHN TODD: I -- I do not -- I have not understood it to be a point forecast --

MR. STEVEN SCARFONE: Oh, I see.

MR. JOHN TODD: -- but it's not my expertise. It may go on. As -- as I understood, it was a minimum for -- in effect, the minimum of a range with no upper end for a competitive insurer.

Remember that -- competitive sure --

insurer, would take any excess over a prudent level and pay it as dividends to the shareholder. This is a completely different model than what we're talking about here.

MR. STEVEN SCARFONE: And -- and in your paper, when addressing the range versus point value dichotomy, that really is the only thing you take issue with, with the build and release provisions in Manitoba's Capital Management Plan -- MPIC's Capital Management Plan, correct?

MR. JOHN TODD: Sort of. The -- I'm also saying that I have not seen an analytic basis for choosing the numbers that go into that test.

MR. STEVEN SCARFONE: Well, you've seen the reserves regulation. With respect, you -- you know where those numbers come from. They come from a regulation.

MR. JOHN TODD: Well -- and not being a lawyer and not being a politician, but being a -- my specialty being regulatory methodology, I look at it and say that's no way to set policy, but, you know, governments override me and the Board will have to deal with that as they see appropriate.

I'm just saying that is not -- that is not -- I would never take that as a base to say the number is correct.

MR. STEVEN SCARFONE: But we don't know, sitting here today, why Cabinet may have come up with those numbers.

MR. JOHN TODD: We do not know; we can only speculate.

MR. STEVEN SCARFONE: Yes. And it could very well be that they did the analysis and came up those numbers. We don't know.

MR. JOHN TODD: Well, it'd make the Manitoba government very different than the ones I've dealt with, but, yes, that's possible.

MR. STEVEN SCARFONE: We -- we don't know, do we, sir?

MR. JOHN TODD: We don't know.

MR. STEVEN SCARFONE: And I just want to go through if I can, quickly, sir, your conclusions on page 15.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: So at line 25, it reads:

"Assuming the PUB determines that generally accepted rate-making

> principles are relevant to the rate approval process, the following considerations should guide this Board's approach in reviewing MPI's rates."

And you've set out one (1), two (2), three (3), four (4), five (5), things for this Board to consider, correct?

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: First of which is to ensure there's no cross-subsidization, and that the Corporation is acting in line with Section 6.3 of the Act.

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And as we've heard, the transfer of capital isn't from basic into the competitive lines, but in fact the opposite.

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: The second bullet is that:

> "MPI's extension and SRE insurance lines are analogous to the non-utility services of other utilities since they are products that are also available from other

participants in the market and are
options for MPIC's customers."

So that recommendation I think goes back to the mischief that the Ontario Energy Board tries to address in its affiliates rules where you don't have an advantage derived without some benefit to the monopoly policyholder.

MR. JOHN TODD: Yes, and -- and which is also addressed for non-utility services of a monopoly through the mechanism of flowing 100 percent of the benefit as a reduction in rates for customers -- reduction to revenue requirement and, therefore, rates.

MR. STEVEN SCARFONE: And -- and I would suggest to you, sir, that the proposed Capital Management Plan, as you've said, provides for a rigorous rule that this Board can use as a -- as a -- as a way of achieving -- or avoiding this mischief.

MR. JOHN TODD: Once the reference point is set in a way that the Board considers to be prudent and --

MR. STEVEN SCARFONE: Appropriate?

MR. JOHN TODD: -- appropriate.

MR. STEVEN SCARFONE: Yes.

MR. JOHN TODD: Yes. And with -- with

-- with the caveat that part of that Capital Management Plan structure is addressing the rate stability question.

It's -- it's specifically addressing that, and again, assuming the Board agrees with that mechanism, has the right degree of rate stability relative to retention of customers' dollars.

MR. STEVEN SCARFONE: Now, the third bullet speaks to the excess earnings, and again that is the amount that's over and above whatever capital target that might ultimately be affixed for the Corporation.

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: And the offsets that you refer to there would be addressed in that case -- again, once the appropriate level is determined, addressed by the Capital Management Plan.

MR. JOHN TODD: Correct.

MR. STEVEN SCARFONE: The fourth bullet talks about requiring cost to be covered, including maintaining prudent reserves for extension and the SRE lines of business.

Do you see that, sir?

MR. JOHN TODD: Yes.

MR. STEVEN SCARFONE: And again, when

you talk about prudent reserves, you mean the appropriate reserves that might be in place either by regulation or otherwise.

MR. JOHN TODD: However they are set, MCT, MCAT (sic), government regulation.

MR. STEVEN SCARFONE: DCAT, you mean?

MR. JOHN TODD: Sorry, DCAT. Or the Board having some alternative.

MR. STEVEN SCARFONE: And lastly, your last bullet there, the word I want to focus on is "entirety," because the recommendation there is that there be some attribution back to the basic line of business to recognize the benefit that the customers should receive and that they would be available in their entirety to support the objectives of the basic RSR.

So that goes back to the language that you corrected me on where I said in part, and you would be of the view all of those excess earnings should be realized by basic customers.

MR. JOHN TODD: Yes. So if you have a point, it's whatever above that -- is above that point target. If it's a range, whatever is above the top end of that range would all go back to customers through some mechanism over some reasonable period of time, based on all the different working pieces functioning together to provide an appropriate -- approaching other objectives such as rate stability.

MR. STEVEN SCARFONE: Just give me one (1) second, please.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: Just one second, Mr. Todd.

(BRIEF PAUSE)

MR. STEVEN SCARFONE: Those are all my questions for Mr. Todd, Madam Chair. I don't know if the Board wants to take a quick break, but Mr. Guerra will have some questions of the other two (2) panel members.

THE CHAIRPERSON: Thank you, Mr. Scarfone.

Can you give us an estimate of how long Mr. Guerra might be? Maybe Mr. Guerra can give us an estimate of how long he might be, just in terms of the end of the day.

MR. ANTHONY GUERRA: I appreciate

that, Madam Chair.

My intention was to be no longer than forty-five (45) minutes. I do want to assure everyone that that was going to always be my intention, never to stray from that.

That said, we are at almost four o'clock right now and there is -- it's very unlikely I would be able to finish by 4:30.

THE CHAIRPERSON: I think we can proceed, however, we cannot sit past five o'clock, and then of course we have PUB counsel and the other Intervener, so --

MR. ANTHONY GUERRA: I appreciate that.

THE CHAIRPERSON: -- we're going to have to talk about the time estimate again for tomorrow in relation to what the schedule looks like.

DR. BYRON WILLIAMS: Madam Chair, if I might just add, in terms of Ms. Sherry's availability, she's available today. I'll have to check -- maybe if we have just a couple of minutes to stand down for a refreshment break and then we'll get right back to it, but I'll check on the availability of the other witnesses as -- as well for tomorrow.

THE CHAIRPERSON: Thank you, Mr.

Williams.

Break for, let's say five (5) minutes, so that we can keep going. Thanks.

--- Upon recessing at 3:55 p.m.

--- Upon resuming at 4:03 p.m.

THE CHAIRPERSON: Mr. Williams, have you had a chance to speak with your --

DR. BYRON WILLIAMS: Yes. So Dr. Simpson and Mr. Todd are both available for tomorrow. Ms. Sherry is not available for tomorrow, so obviously we would recommend making sure we address her questions today.

I did speak to PUB counsel. They do have some questions for Ms. Sherry. I do not believe that the insurance brokers have questions for Ms. Sherry. They have one (1) question for Mr. Todd.

So what I would recommend is we pay attention to the -- the time frame. PUB counsel have to advise if -- hopefully we finish the MPI cross in time to give PUB counsel the chance to do that, but that's up to the Board.

THE CHAIRPERSON: Thank you very much, Mr. Williams. What we would like to do is do the cross-examination of Ms. Sherry, both MPI and Board counsel, and we'll see where we're at in terms of time.

As I indicated earlier, we have to be concluded by five o'clock, so we'll proceed on that basis and then if it's necessary we'll have to ask Dr. Simpson and Mr. Todd to come back tomorrow morning, so we'll determine that at the end of today.

Please proceed, Mr. Guerra.

CROSS-EXAMINATION BY MR. ANTHONY GUERRA:

MR. ANTHONY GUERRA: Thank you. The only thing I would note is that, unlike last year, this year's presentation by Dr. Simpson and Ms. Sherry offered a position that was kind of intertwined and it's not as neatly undone or untwined as it -- as it was in the previous year, and so I -- I will do my best to direct the questions that Ms. Sherry would be able to answer to her, but there -- there's definitely going to be some overlap and so I will do my best.

Okay. And -- and thank everyone for accommodating and I appreciate that we are under a time crunch. I will do my best to make sure we -- we motor through these questions as -- as best we can.

And just so you're aware, if -- if

there's any question that is misdirected, please feel free to make sure that it's directed to the person most suitable for that, and if it needs to be answered tomorrow, we can do that as well.

Just to confirm, Ms. Sherry, you are an actuary, an accountant, correct?

MS. ANDREA SHERRY: That's correct, yes.

MR. ANTHONY GUERRA: And you are not an economist, correct?

MS. ANDREA SHERRY: No, I'm not.

MR. ANTHONY GUERRA: And you are not a lawyer, correct?

MS. ANDREA SHERRY: Correct.

MR. ANTHONY GUERRA: And just to confirm, your counsel on June 27, 2019, wrote a letter to the Public Utilities Board that outlined your area of expertise, and in that letter -- I'm just going to paraphrase to get us through this, but hopefully you'll -- you'll agree with me that the letter indicates that your proposed area of expertise is actuary analysis with a particular focus on pricing, rate-making, and risk related to automobile insurers generally, including Crown-owned automobile insurers, correct?

MS. ANDREA SHERRY: I think you've got Dr. Simpson's up here. Okay, yeah.

MR. ANTHONY GUERRA: Dr. Simpson would be the applied economic -- econometrics applied microeconomics and quantitative methods, correct?

MS. ANDREA SHERRY: No, that's right. I just saw Dr. Simpson there's, so I thought --

MR. ANTHONY GUERRA: Okay. Thank you. And -- and that is a fair analysis of, or a fair characterization of your area of expertise?

MS. ANDREA SHERRY: Yes.

MR. ANTHONY GUERRA: And is it fair to say that your report titled, "Protecting consumers against risk, how far should it go," that you co-authored that report with Dr. Simpson?

MS. ANDREA SHERRY: I did, yes.

MR. ANTHONY GUERRA: And in co-authoring that report, the opinions expressed in that report are your opinions expressed as a professional, correct?

MS. ANDREA SHERRY: Yes.

MR. ANTHONY GUERRA: And you will advise me during the course of our cross-examination if you're going to be offering opinion that is not a professional opinion, correct?

MS. ANDREA SHERRY: I will --

MR. ANTHONY GUERRA: Thank you.

MS. ANDREA SHERRY: -- do my best to do so, yes.

MR. ANTHONY GUERRA: And I -- and I remind you if it may -- may come across as not a professional opinion, but I hope that we won't get to that point.

(BRIEF PAUSE)

MR. ANTHONY GUERRA: Thank you. So let's turn to the report then, which is Exhibit CAC 12-1, in particular page 11 of the report.

It ends with the following recommendation: "The CMP" and by CMP I'm -- I'm referring to what I understand to be the Capital Management Plan. Would you agree with that?

MS. ANDREA SHERRY: Yes.

MR. ANTHONY GUERRA: Okay. So the Capital Management Plan, or CMP,

"should continue to use the DCAT"

-- or Dynamic Capital Adequacy Test, correct?

MS. ANDREA SHERRY: M-hm.

MR. ANTHONY GUERRA: "Yes" or "no."
MS. ANDREA SHERRY: Yes.
MR. ANTHONY GUERRA: Thank you.

"Results within a one (1) in forty (40) year adverse scenario as the benchmark or ra -- range midpoint to determine a target for the RSR, or Rate Stabilization Reserve."

MS. ANDREA SHERRY: That's correct.
MR. ANTHONY GUERRA: thank you. And -- and so that is a fair -- that is your recommendation, correct? That's --
MS. ANDREA SHERRY: Correct.
MR. ANTHONY GUERRA: -- something you share with Dr. Simpson as a joint recommendation?
MS. ANDREA SHERRY: Yes.
MR. ANTHONY GUERRA: And so to extrapolate from that, is it fair to say then that you -- you would not -- you would not agree -- you -- you do not believe that the Public Utilities Board should endorse the use of the Capital Management Plan that is currently proposed by MPI?
MS. ANDREA SHERRY: I'm saying that I don't think that target range is embedded in the plan is -- is the right one to use.

MR. ANTHONY GUERRA: Right. And -- and that's because the Capital Management Plan is based on this 100 percent MCT, or Minimum Capital Test, single target, and not on an upper and lower range, correct?

MS. ANDREA SHERRY: Based on the DCAT.

MR. ANTHONY GUERRA: Right. You would say -- you -- you would -- you would ask that this Board approve a Capital Management Plan that would be based upon a DCAT analysis as opposed to a MCT analysis, correct?

MS. ANDREA SHERRY: That's what we're recommending, yes.

MR. ANTHONY GUERRA: Okay. And so just to confirm with respect to the use of the DCAT for -- for determining the upper and lower ends of the RSR targets, the lower would be based on a one in forty (40) year probability level with routine management regulatory action over a two (2) year time horizon, correct?

MS. ANDREA SHERRY: Subject to check, I believe that's the correct one, yes.

MR. ANTHONY GUERRA: Okay. And -- and this lower target, this is to ensure that the total -- basic total equity level remains above zero, correct?

That's the purpose?

MS. ANDREA SHERRY: No. I -- I wouldn't necessarily -- I would say -- I would state it another way just say it would determine the level of the RSR, be -- are you asking about the total equity level when you run scenarios --

MR. ANTHONY GUERRA: So when -- when --

MS. ANDREA SHERRY: -- or are you asking --

MR. ANTHONY GUERRA: Sorry, I don't want to talk over you, but what I'm proposing is that the -- the lower level of the RSR, the lower target of the RSR if you will --

MS. ANDREA SHERRY: M-hm.

MR. ANTHONY GUERRA: -- the purpose of estab -- setting that target would be to -- that's the -- the point at which we ensure that basic total equity would remain above zero, correct?

MS. ANDREA SHERRY: If certain adverse scenarios were to occur.

MR. ANTHONY GUERRA: Fair enough.

MS. ANDREA SHERRY: Yeah.

MR. ANTHONY GUERRA: And so the upper target, I would submit, agree with me if you -- if you do, that it's based upon a one (1) in forty (40) year probability level with no management action over a two (2) year time horizon, correct? Is that what's being advocated in that -- that use of the DCAT?

MS. ANDREA SHERRY: I don't think in this -- point me to the -- to the section where we list which scenarios we suggest to use. I'm not sure that we did in this paper.

MR. ANTHONY GUERRA: No, you don't, and that's why --

MS. ANDREA SHERRY: Yeah.

MR. ANTHONY GUERRA: -- I'm trying to --

MS. ANDREA SHERRY: So that's why --

MR. ANTHONY GUERRA: -- confirm that.

MS. ANDREA SHERRY: Right. So I would have to go back and look to confirm which scenarios we would recommend.

DR. BYRON WILLIAMS: And I -- I just have to -- in fairness to our witness, my understanding is for the 2020/21 year...

(BRIEF PAUSE)

DR. WAYNE SIMPSON: I think what you're referring to is some earlier suggestions we made about how you might -- as the PUB was grappling with this question, about how you might use the DCAT to develop a risk RSR range, and that was based actually not on a particular scenario because the scenario that was chosen would depend upon what was considered to be the most adverse event, but once that was chosen, to look at the question of risk tolerances, which we addressed again, and that was to say that you get a wider RSR range the wider the gap in risk tolerances, and you do those around the one (1) in forty (40) year -- your standard issue midpoint, and so we suggested some ranges, a narrow range and a broad range, based essentially on a gap in risk tolerances. That didn't depend on the particular scenario chosen. The scenario chosen was based on adversity.

MR. ANTHONY GUERRA: Right. And -- and as -- Ms. Sherry, as you've correctly pointed out, there isn't a -- a detailed indication in -- in your report as to what the DCAT might look like if -- if the -- the PUB were to -- to use it instead of the hundred percent MCT for -- for the Capital Management Plan.

So is it fair to say then that, based upon your -- your evidence today, that you -- you haven't quite turned your mind as to what that DCAT might look like?

MS. ANDREA SHERRY: Well, we have looked at it in the past and we've had a great deal of discussion here at the PUB about what DCAT scenarios should be used, so -- but the point of this paper in particular was not to direct which ones -- which scenarios should be used.

MR. ANTHONY GUERRA: Okay. Is it fair to say though that the opinions expressed in your report are based on a couple of assumptions, and correct me if I'm wrong -- the first assumption is that the reserves regulation that is referenced in your report is not valid.

That's an assumption that you're making when you're preparing your opinions in your report, correct?

MS. ANDREA SHERRY: That would be an assumption of the recommendation, yes.

MR. ANTHONY GUERRA: Okay. And another assumption that's being made in the report is that the -- the PUB can approve a target for the rate stabilization reserve that differs from the 100 percent minimum capital test target prescribed in the reserves regulation for that Basic RSR, correct?

That's an assumption that's being made?

MS. ANDREA SHERRY: I'm not a lawyer--

MR. ANTHONY GUERRA: No --

MS. ANDREA SHERRY: -- as you said earlier.

MR. ANTHONY GUERRA: -- but your -- your opinion is based --

MS. ANDREA SHERRY: But --

MR. ANTHONY GUERRA: -- on an assumption, correct?

MS. ANDREA SHERRY: Yes.

MR. ANTHONY GUERRA: Okay. And -- and on that point about not being a lawyer, you would agree that you aren't qualified to provide professional opinions respecting either the validity of the reserves regulation or the jurisdiction of the PUB to approve an RSR target that differs from the prescribed target in the reserves regulation, correct?

MS. ANDREA SHERRY: That's correct. All we can do is recommend what we believe would be a better choice if the reserves regulation is not found valid.

MR. ANTHONY GUERRA: And it's fair to say, Ms. Sherry, that in the event that either of those two (2) assumptions are wrong, so in the event that the reserves regulation is valid, and -- and the PUB does not have jurisdiction to stray away from its requirements, you have not expressed an opinion in your report as to what the appropriateness of the proposed Capital Management Plan by Manitoba Public Insurance would be, correct?

MS. ANDREA SHERRY: We have not, no.

(BRIEF PAUSE)

MR. ANTHONY GUERRA: My Friend touched upon the area of the purpose of the RSR, and I think it's important that we -- we talk about that a little bit more from your perspective, because I -- I -- we don't -- I want to hear from your perspective.

It's been stated, I think, fairly frequently what the purpose of the RSR is, but just to confirm, you would agree with me that the purpose is to protect motorists from rate increases that would otherwise have been necessary due to unexpected variances from forecasted results and due to events and losses arising from non-reoccurring events or factors?

MS. ANDREA SHERRY: That sounds correct.

MR. ANTHONY GUERRA: Okay. And -- and subject to check. I may have missed a word or two (2) there, but I think I got it down pretty good.

MS. ANDREA SHERRY: Yeah.

MR. ANTHONY GUERRA: And -- and in your report, yourself and -- and Dr. Simpson have -- have focused -- or zeroed in on the word 'motorists'.

You agree with me that -- that's an important consideration for you within the context of that statement?

MS. ANDREA SHERRY: I would agree that it's the treatment -- and the fair treatment of motorists is important to us, yes.

MR. ANTHONY GUERRA: Right. So we go back to the statement, to protect motorists. You're saying that's important. We have to step back and say that the purpose of the RSR is to protect motorists. It's not to protect MPI. It's to protect motorists, correct?

MS. ANDREA SHERRY: Correct.

MR. ANTHONY GUERRA: And -- and what we're protecting motorists from with the -- the RSR is -- is from rate shock, correct?

MS. ANDREA SHERRY: Yes.

MR. ANTHONY GUERRA: And --

MS. ANDREA SHERRY: I would say that -- I would agree with that, yeah.

MR. ANTHONY GUERRA: Okay. And -- and have you formulated -- have you thought about what the term rate shock means to you?

MS. ANDREA SHERRY: I've read some of the transcripts, and I know it's been heavily talked about and debated. What -- I think rate shock means different things to every individual.

But I've seen the 5 percent has been the general consensus, that that would be a large enough rate increase.

MR. ANTHONY GUERRA: And -- and to confirm, we are talking about rate increases? We're not talking about a 5 percent dec -- decrease being shocking to anyone, correct?

MS. ANDREA SHERRY: Right. I would probably agree with that.

MR. ANTHONY GUERRA: And -- and in fairness, the -- the purpose -- the real purpose, it -- aside from what we've talked about in terms of the -- the caption I read to you, is more than just protecting motorists from rate shock.

And -- and the reason why I'm saying that -- and -- and I will put it to you, and you can agree with me if you want, is that the term rate shock doesn't actually appear in that statement that I read to you? There -- there's no indication --

MS. ANDREA SHERRY: I agree. Yeah. I was going to clarify that, but I thought that was.

MR. ANTHONY GUERRA: And -- and another thing I want to point out, and -- and you can agree with me if you -- if you choose to, which is the statement of the Board in the 2000 -- in the context of the 2018 GRA, and in particular, in referring to PUB Order 130-'17, where the PUB said:

> "The lower threshold mitigates the risk of insolvency and protect the interests of ratepayers, and in particular, claimants. It insures that Basic insurance is sufficiently capitalized to provide a reasonable comfort that it will be able to meet its policyholders' obligations."

Would you agree with me that that's also a purpose of the RSR, or even effect of the RSR?

MS. ANDREA SHERRY: Can you --

MR. ANTHONY GUERRA: Absolutely. Yes. You can turn to page 78, Ms. Schubert. Thank you.

(BRIEF PAUSE)

MS. ANDREA SHERRY: Whereabouts is it?

MR. ANTHONY GUERRA: It starts with the -- the phrase, "The lower threshold mitigates."

MS. ANDREA SHERRY: Yeah. Can you go up a little bit, please? There we go.

MR. ANTHONY GUERRA: There we go, right in the middle of that paragraph, there.

(BRIEF PAUSE)

MS. ANDREA SHERRY: That's interesting.

MR. ANTHONY GUERRA: Why do you say it's interesting, Ms. Sherry?

MS. ANDREA SHERRY: Well, because it says the lower threshold mitigates the risk of insolvency and protects the interests of ratepayers, and in particular, claimants.

MR. ANTHONY GUERRA: Would you agree with that statement?

MS. ANDREA SHERRY: I've always...

(BRIEF PAUSE)

MS. ANDREA SHERRY: I don't know that it's possible for MPI to go insolvent. I don't know how that would occur.

MR. ANTHONY GUERRA: Right. We've had this discussion before.

MS. ANDREA SHERRY: Yeah. This -- we've gone back and forth on that, so I -- I -- that's why the word 'insolvency' made me pause.

MR. ANTHONY GUERRA: And I'm putting to you what is in this Board Order.

MS. ANDREA SHERRY: I know.

MR. ANTHONY GUERRA: You -- you may not agree with it, and that's I guess what I'm asking you, is -- is this something that you agree with?

MS. ANDREA SHERRY: I would say that the lower threshold mitigates the risk of large rate change -- changes being required more so than the risk of insolvency.

MR. ANTHONY GUERRA: What about the sentence:

> "It insures that Basic insurance is sufficiently capitalized to provide a reasonable comfort that it will be able to meet its policyholders obligations."

Do you agree with that statement?

MS. ANDREA SHERRY: That I would agree with, yes.

MR. ANTHONY GUERRA: In other words, motorists must have faith that MPI will always be able to pay its claims, correct, or pay their claims?

MS. ANDREA SHERRY: Correct.

(BRIEF PAUSE)

MR. ANTHONY GUERRA: And would you agree with me that from another perspective, from the perspective of the government, the government might be interested in making sure that MPI has sufficient capital to pay claims when they become due?

MS. ANDREA SHERRY: Of course.

(BRIEF PAUSE)

MR. ANTHONY GUERRA: There's a discussion in your report about the -- the concept of absolute protection. And -- and there's a statement in the report about -- or the statements to the extent of absolute protection would be prohibitively expensive and unaffordable for most uti -- for most motorists. That's at page 6 of your report.

Do you recall that?

MS. ANDREA SHERRY: Yes, I do.

MR. ANTHONY GUERRA: Can -- can you tell me what you mean by the term absolute protection?

MS. ANDREA SHERRY: Pardon me.

MR. ANTHONY GUERRA: Is that just absolute protection from rate shock, or is that something bigger?

(BRIEF PAUSE)

MR. ANTHONY GUERRA: Sorry.

(BRIEF PAUSE)

MS. ANDREA SHERRY: It seems when I talk, it gets worse. What we were talking about there, and Wayne can step in if he would like as well, but the hot -- the more you hold in an RSR, the more costly it becomes for the motorists of Manitoba.

And there is a trade-off, right, from MPI holding money that the consumer could hold. And if the consumer is holding that money, there's all sorts of other economic benefits to that in our community, right?

So if you hold enough money to feel a hundred percent confident that nothing could ever happen that would hurts -- or get MPI's total equity below zero, you're taking way too much money from people, right?

So it is about a balance. And the question we're raising in that is how much does your average person -- how much risk are they willing to assume -- them -- without having to pay every year for MPI to hold it?

Do you know -- does that make sense somewhat?

MR. ANTHONY GUERRA: I -- I think I'm following you.

MS. ANDREA SHERRY: Okay.

MR. ANTHONY GUERRA: Okay. And -- and --

MS. ANDREA SHERRY: Wayne can step in, because he's got a voice.

DR. WAYNE SIMPSON: Sure.

MR. ANTHONY GUERRA: And if you've got -- Dr. -- sorry, Dr. Simpson, if you do have something -- and -- and I apologize, but there is going to be some, you know --

DR. WAYNE SIMPSON: No, you -- you --
MR. ANTHONY GUERRA: -- connection between --
DR. WAYNE SIMPSON: -- you referred to the combine centre, for example. So it -- it draws from -- from the different adverse scenarios you -- you describe in the DCAT. And the total equity scenario would be one (1). The interest rate scenario would be another. And the claims -- the high loss claims scenario would be the third.
And you're drawing from that 2.5 percent tail for a 1:40. But to get absolute protection, you're not even drawing from the very worst case in each of those opportunities, because that's based on just recent experience with the data.
So you might imagine that there's actually worse cases out there, you know, so-called black swan effect. But if you did that, you would at least be approaching what you would call absolute protection. And we have no idea what kind of a -- a reserve ratio that would imply, because even the hundred percent MCT at .02 percent wouldn't qualify as absolute protection.
MR. ANTHONY GUERRA: Okay. And -- and I think you've --

DR. WAYNE SIMPSON: And that's the 1:15 figure.

MR. ANTHONY GUERRA: Right, and -- and I think you have stolen a bit of my -- my thunder, because I was going to talk about this 1:5000 year scenario, or the -- the 0.0002 percent probability of occurrence.

And -- and if I can clarify or confirm, your position is even that although perhaps critical of -- of MPI in -- in indicating that 100 percent MCT would -- running the sim -- simulations using the hundred percent MCT, that would not result in -- in any scenario within those five thousand (5000) runs that would draw down the RSR below zero.

Your position would still be that that -- even that is not sufficient enough to provide what you would call absolute protection, correct?

DR. WAYNE SIMPSON: A -- a motorist may be so risk-averse. I cannot conceive of such a person, but, you know, I mean, you would -- you would think it would be, they would have problems, significant problems, but a motorist could be so risk-averse that even a .02 percent possibility of occurrence would not be satisfactory to them, that they would want further insurance, and further risk protection than -- than that.

The floodway is an example. We want 1:700 year protection there, but that's a much bigger consequence if things go badly than -- than if there's rate shock.

MR. ANTHONY GUERRA: Right. And so using the floodway as a perfect example, 1:700 year scenario, I believe it's what it's supposed to represent, correct?

DR. WAYNE SIMPSON: That's the educated guess, I would say, yes.

MR. ANTHONY GUERRA: And -- and so obviously running the 100 percent MCT criterion, assuming management action, by the way, gets us to a 1:5000 year scenario -- or probability of occurrence.

Your -- that was clearly above what occurrence levels lead -- the floodway would -- would protect against, correct?

DR. WAYNE SIMPSON: Yes.

MR. ANTHONY GUERRA: Although not representing absolute protection, you would agree with me would offer most motorists what they might characterize as absolute protection, or protection -- such a high protection that they need not worry?

MR. ANTHONY GUERRA: Well, the basic

principle here is the more protection you buy, the more it costs. It's a pretty simple principle.

DR. WAYNE SIMPSON: And at some point, it becomes cost prohibitive, correct?

DR. WAYNE SIMPSON: At some point, well, yes, at some -- different points for different people, depending upon their preferences and their incomes.

MR. ANTHONY GUERRA: Would it be fair to say, though, in -- in your opinions and -- and hopefully you agree on this; if not, let me know -- that -- that protection at the 100 percent MCT level is not -- or is cost prohibitive for motorists?

That's your -- is that your position?

DR. WAYNE SIMPSON: I would imagine that for some, that is the case, yes. There's an affordability question based on -- on income.

MS. ANDREA SHERRY: I would agree.

MR. ANTHONY GUERRA: So what I want to do, then, is I want to turn your attention to MPI Exhibit number 66, which is the quarter -- second quarter financial results for MPI. And if we can go down to the next page. Thank you, Ms. Schubert. Another page down, please.

All right. So what we see here, and

I'm particularly interested in the -- the box under organizational health.

What we see here is the -- the minimum capital test status for each of the three (3) lines of business, Basic being at 97 percent MCT as it currently stands, with a target of 100 percent, and so on. But I'm most interested in the Basic level right now.

So you agree with me -- or have no reason to disagree with me that as it currently stands, Basic's RSR is currently at an MCT ratio of 97 percent, correct?

MS. ANDREA SHERRY: I would agree, yeah.

(BRIEF PAUSE)

MR. ANTHONY GUERRA: And I'm going to refer you to another MPI exhibit. This is MPI Exhibit number 42, please.

(BRIEF PAUSE)

MR. ANTHONY GUERRA: This is a letter from MPI to the Board. And in particular, I'm -- I'm referring to page 3.

(BRIEF PAUSE)

MR. ANTHONY GUERRA: And sorry, if you can scroll to the top, there, please, the paragraph that starts, "Given Basic's." So:

> "Given Basic's progression towards the 100 percent MCT capital target, there was no requirement for a bill provision under the Capital Management Plan. MPI still seeks approval of the overall Capital Management Plan, and will continue to apply the Capital Management Plan as intended in the next year's GRA based on the revised 2020 GRA forecast. If favourable results continue, a capital release may be appropriate at that time."

Do -- do you see that paragraph, Ms. Sherry and Dr. Simpson?

MS. ANDREA SHERRY: I do, yes.

MR. ANTHONY GUERRA: And so what I -- what I'm going to suggest to you is that what MPI is doing in the context of this rate application is not asking for a bill provision under its proposed Capital Management Plan, and is in fact suggesting that there may be a position where it can release capital in the future forecast.

Do you agree with that?

MS. ANDREA SHERRY: I agree with the fact -- like, what you just said, laying out the facts. I don't think that really has any bearing on the determination of what the RSR levels should be, though, right?

And this is the result, and that's -- that's good that MPI has had a good year. It's good that MPI doesn't have to take rate increases. But if they are still, in fact, holding more capital than they should in terms -- in relation to the -- the purpose of MPI, I suppose, and what the ratepayers should be paying, then that's -- that's two (2) different things.

MR. ANTHONY GUERRA: There's a critique in your report about being socially wasteful.

Do -- do you recall that? It's page -- page 6 --

MS. ANDREA SHERRY: I don't know where it is.

MR. ANTHONY GUERRA: -- of the report.

MS. ANDREA SHERRY: Page 6?

MR. ANTHONY GUERRA: Yes, please.

There's a sentence that says in the report:

> "Unless motorists value absolute protection more than other goods and services, this would be a misallocation of their resources and socially wasteful, from a utilitarian perspective."

MS. ANDREA SHERRY: That's right. And that's basically what I was talking about just now.

MR. ANTHONY GUERRA: Right.

MS. ANDREA SHERRY: M-hm.

MR. ANTHONY GUERRA: So is the critique that money held by MPI is money that is no longer available to ratepayers to spend on goods or services, or to invest?

MS. ANDREA SHERRY: Well, it's money out of their pocket that they may need for other things. And yes, it does have an impact on the economy.

MR. ANTHONY GUERRA: Right. And so your -- your argument, or your position is that having

MPI hold onto that money would essentially hurt the Manitoba economy.

Is that correct?

MS. ANDREA SHERRY: I think a -- the other way of saying it is that releasing money that MPI does not need to hold would have a positive effect on the economy.

MR. ANTHONY GUERRA: Right. And -- and we can use -- so we can go back this term that is coined -- or at least referenced in the report, which is this utilitarian --

MS. ANDREA SHERRY: M-hm.

MR. ANTHONY GUERRA: -- term. And my understanding is that utilitarian refers, at least according to -- to you in your report, that a -- utilitarian means that not -- or maximizing the well-being of a majority of the population, correct?

MS. ANDREA SHERRY: I think I should give that question to my economist --

MR. ANTHONY GUERRA: Sure. Thank you.

DR. WAYNE SIMPSON: Yes. Well, I -- I qualified this comment by being precise about what I meant by socially wasteful, because -- but it's the economist's standard notion, which is that you're looking for the best outcome for the best -- largest number of people, assuming that individuals are a better judge of how to spend their money to -- for their own satisfaction than MPI, or other public bodies, or other benevolent agents.

MR. ANTHONY GUERRA: Fair enough, Dr. Simpson, but -- and -- and I think that you -- you've said it correctly when you -- you say there's an assumption there on the part of Manitobans, you would agree with me that it's impossible to predict, though, with any level of certainty, what, in fact, Manitobans would do with money rebated from the RSR, correct?

DR. WAYNE SIMPSON: I -- I think if you look at -- at studies of consumption patterns and studies of -- of spending by Canadians and Manitobans, there are surveys on this -- it's pretty easy to predict what -- what people might do with those kinds of things, so -- with money, with money that came to them that they did not expect to have.

All right. I don't -- I don't think it's true that we can't predict it.

MR. ANTHONY GUERRA: Well, obviously, it would depend on the amount of money, correct?

DR. WAYNE SIMPSON: Not in principle, no.

MR. ANTHONY GUERRA: So you would

agree, though, that some Manitobans might not spend their money on goods and services that would benefit the Manitoba economy, correct?

DR. WAYNE SIMPSON: I disagree. They would almost certainly spend it on -- money, some of which would stay in Manitoba, would benefit the Manitoba economy.

The multiplier for Manitoba studies of that, with which I know quite a bit, are suggested. In fact, a significant fraction of it would not only be spent here, but also would be re-spent here.

MR. ANTHONY GUERRA: But my question to you, Dr. Simpson, was about whether or not some might not spend money on goods and services that benefit the Manitoba economy. So --

DR. WAYNE SIMPSON: They might go to Calgary --

MR. ANTHONY GUERRA: -- there's some that might not?

DR. WAYNE SIMPSON: -- buy a trip, and go elsewhere, but that's probably a minority.

MR. ANTHONY GUERRA: And -- and there's some that might not choose to invest that money in -- in companies that benefit the Manitoba economy, correct?

DR. WAYNE SIMPSON: Anything's possible, but those are not the normal activities of Manitoba consumers.

MR. ANTHONY GUERRA: And -- and if individuals were to spend money on goods and services that were of no benefit to the Manitoba economy, or were not to invest in companies that would benefit the Manitoba economy, that would not be utilitarian, correct?

DR. WAYNE SIMPSON: It would be utilitarian, because they're getting their bit -- mat -- their own personal highest benefit from it.

MR. ANTHONY GUERRA: But I thought the definition of utilitarian, meaning to maximize the well-being of the majority of the population?

DR. WAYNE SIMPSON: Yes, but for the individual, they're maximizing their own personal benefits. So you can't criticize the individual. You can only criticize it from the social standpoint of the group, which was -- you referred to socially wasteful.

And so, in fact, since the majority of people will not be doing as you suggest, then you can't say that because one (1) person does, that, in fact, that's not -- that's wasteful from a utilitarian perspective. That person is doing what they think is correct.

MR. ANTHONY GUERRA: Your opinion about --

THE CHAIRPERSON: Mr. Guerra --

MR. ANTHONY GUERRA: Yes?

THE CHAIRPERSON: -- I'm going to stop you here. You're dealing with economics issues, and I would like to give PUB counsel an opportunity to cross-examine Ms. Sherry before we're done today.

MR. ANTHONY GUERRA: I appreciate that.

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

(BRIEF PAUSE)

MR. ANTHONY GUERRA: I have further questions for Ms. Sherry, but I -- I don't think that's going to be allowed, so I'll -- I'll stop for today.

CROSS-EXAMINATION BY MR. ROBERT WATCHMAN:

MR. ROBERT WATCHMAN: Thank you. Ms. Sherry, I just have three (3) areas of actual practice that I wanted to question you about, and I apologize if the introduction's a little abrupt.

MS. ANDREA SHERRY: That's okay.

MR. ROBERT WATCHMAN: But to get right to it --

MS. ANDREA SHERRY: M-hm.

MR. ROBERT WATCHMAN: -- Kristen, if we could go to the bottom of page 3 of Dr. Simpson and Ms. Sherry's report.

(BRIEF PAUSE)

MR. ROBERT WATCHMAN: And to put this into context, this is addressing your concern with respect to the significant change in procedure, namely, the use of 100 percent minimum capital test.

And if we go to the last sentence in that paragraph:

"While the MCT is recognized by the Office of the Superintendent of Financial Institutions for private casualty insurers, in a competitive insurance industry, to prevent insolvency, it was unclear, at least to stakeholders, how this applied to

a public Crown Corporation with a
monopoly over Basic insurance."

Do you -- do you recall that?

MS. ANDREA SHERRY: Yes. I -- m-hm.

MR. ROBERT WATCHMAN: And specifically, is your concern here the applicable -- the applicability of the minimum capital test itself, or is it the setting of the ratio at 100 percent?

MS. ANDREA SHERRY: I have concerns with both. The MCT is a test, and it's calibrated on private insurance companies, right? So for MPI to use it, for a Crown monopoly to use it, we should be looking at the -- all of the tests that are -- make up the MCT calculation. And they're individual little tests related to different types of risks. And we should be looking at that and seeing if it even applies to a Crown. That's my first concern.

And then the second concern is the 100 percent.

MR. ROBERT WATCHMAN: And you just -- could you explain the concern about the 100 percent?

MS. ANDREA SHERRY: Well, because again -- I guess they were very related, right? Because if the test is calibrated to prevent the insolvency of a private insurance company writing multiple products across the -- in many cases, in several provinces across Canada, and something was said earlier, too, saying that private insurance company have to hold 150 percent MCT.

That is the supervisory target, but insurance companies in Canada, generally speaking, carry way more than that, depending if there is stock company, or a mutual, et cetera, et cetera.

So all of these things make -- I think it's really inappropriate just to say this task that is created and calibrated for private insurance companies that have a completely different risk profile than -- than Manitoba Public Insurance should be used for Manitoba Public Insurance, and we're going to say a hundred percent.

But we -- we have nothing to say if these -- this test is even applicable, right? So I -- they're related.

MR. ROBERT WATCHMAN: Okay. Kristen, if we could turn to the application, Part 6, DCAT Appendix 1(d).

And Ms. Sherry, perhaps this is something you might be willing to undertake to take away and get back to us on.

MS. ANDREA SHERRY: Okay.

MR. ROBERT WATCHMAN: So -- and -- and you see here, this is the -- the determination of -- or the application of the minimum capital test.

MS. ANDREA SHERRY: M-hm.

MR. ROBERT WATCHMAN: And the question is whether there are any specific elements within this derivation of the minimum capital test ratio that you believe are of questionable applicability to a public Crown Corporation.

MS. ANDREA SHERRY: It would take me some time to go through it, and I think that's something that I -- that I think, quite frankly, was on MPI's shoulders to do is to prove that this test applied to them, to look at these elements, and to say what applies to MPI, what doesn't, what should we recalibrate for a Crown.

I certainly don't mind undertaking it, but I'm not sure I'm the best person for the job.

MR. ROBERT WATCHMAN: Okay. Well, if we could have that undertaking.

MS. ANDREA SHERRY: You -- pardon me?

MR. ROBERT WATCHMAN: If we could have that undertaking, please?

DR. BYRON WILLIAMS: So --

MR. ROBERT WATCHMAN: M-hm.

DR. BYRON WILLIAMS: -- just so I understand the undertaking, whether there are any specific elements in the derivation of the min -- minimum capital test as set out in Appendix 1(d) of the DCAT analysis.

You're asking for that undertaking for Ms. Sherry?

MR. ROBERT WATCHMAN: Yes, we --

MS. ANDREA SHERRY: I would like the -- if possible, to get the -- sorry.

MR. ROBERT WATCHMAN: Just hold -- hold on. Yes, whether she considers any of those elements to be of questionable -- questionable applicability to a public Crown Corporation.

(BRIEF PAUSE)

DR. BYRON WILLIAMS: Mr. Watchman, in a -- or legal counsel for the PUB, and -- what would be helpful would be to actually see the working papers of MPI, so that -- and so she may be able to approach this from a conceptual level. The entirety of the answer would not be possible without having access to the working papers, sir.

MS. ANDREA SHERRY: I can give you

theoretical reasons why it might not apply to MPI, but to re-create their MCT myself would seem to be a waste of time if I can get their Excel spreadsheet.

MR. ROBERT WATCHMAN: No, fair enough. We -- we don't -- we're not asking you to re-create it. I think just, you know, your --

MS. ANDREA SHERRY: Theoretically?

MR. ROBERT WATCHMAN: -- prin -- yes, your theoretical --

MS. ANDREA SHERRY: Okay.

MR. ROBERT WATCHMAN: -- consideration of the test as applied.

MS. ANDREA SHERRY: Okay.

DR. BYRON WILLIAMS: So we'll limit the undertaking to the conceptual challenges, and not to the practical applicability, as would be evidenced by the -- an analysis of the MC -- of the Manitoba Public Insurance working papers.

MR. ROBERT WATCHMAN: Yes, that's -- that's fine.

THE REPORTER: So what is the actual undertaking?

DR. BYRON WILLIAMS: We're going to leave that to PUB counsel, because he's got most of the words in front of him.

MR. ROBERT WATCHMAN: So the undertaking would be to provide a analysis on a theoretical basis or a conceptual basis of Appendix 1(d) of the DCAT section of the application to indicate whether there are any specific elements within the derivation of the MCT ratio that are of questionable applicability to a public Crown Corporation.

DR. BYRON WILLIAMS: That's accepted.

--- UNDERTAKING NO. 36: CAC to provide a analysis on a theoretical basis or a conceptual basis of Appendix 1(d) of the DCAT section of the application to indicate whether there are any specific elements within the derivation of the MCT ratio that are of questionable applicability to a public Crown Corporation

CONTINUED BY MR. ROBERT WATCHMAN:

MR. ROBERT WATCHMAN: Thank you. If

we could turn, Kristen, to Information Request PUB-CAC-1-2.

(BRIEF PAUSE)

MS. ANDREA SHERRY: Okay.

MR. ROBERT WATCHMAN: And just -- just quickly, the -- you see the -- the question there, question A, related to the Corporation's proposed management -- Capital Management Plan, which appears to embed any resulting capital release provision into the Basic -- or the proposed Basic rates.

And if we could scroll down to the answer to Part A. There, it begins there.

And it's just the beginning of the second sentence, there:

"The calculation of the actuarially indicated rate should not be complicated by the capital build or release decisions."

And this is the part I want to focus on.

"The investment income from the investment fortpole -- portfolio backing the Basic insurance portfolio at the amount it is expected to be for the rating year in question should be part of the actual -- actuarial indication -- sorry -- actuarial rate indication calculation."

Do you recall that answer?

MS. ANDREA SHERRY: I do, yes.

MR. ROBERT WATCHMAN: And in earlier discussions with MPI witnesses, both in this hearing and in previous hearings, the matter of the expected return on investment assets supporting Basic total equity --

MS. ANDREA SHERRY: M-hm.

MR. ROBERT WATCHMAN: -- and the recognition of that Basic insurance cash flow in -- in estimated -- estimating the Basic rate indications has been addressed.

You're familiar with that?

MS. ANDREA SHERRY: Yes, I recall.

MR. ROBERT WATCHMAN: And -- and that's what you were -- in that last part there, that -- does that -- that's what you're speaking about, the investment income from the investment portfolio backing the Basic insurance?

MS. ANDREA SHERRY: Well, I can't resist an opportunity to bring it up, so I brought it up there. Yes, I was talking about the investment income, and I say from the investment portfolio backing the Basic insurance portfolio, and to me, that's the whole portfolio.

MR. ROBERT WATCHMAN: Okay. And now, are you aware that it's MB -- MPI's position that the expected return on investment assets supporting Basic total equity is a capital adjustment and that they prefer to address all capital adjustments separately from the Basic rate indication as part of the capital management plan?

MS. ANDREA SHERRY: Yes, I am aware of that.

MR. ROBERT WATCHMAN: And is it -- is it your view that that is a -- a cor -- a proper approach or that the expected return on investment assets supporting total -- Basic total equity should be recognized in estimating the Basic rate indication?

MS. ANDREA SHERRY: That is my preferred approach.

MR. ROBERT WATCHMAN: Okay.

MS. ANDREA SHERRY: That it should be part of the actuarial rate indication.

MR. ROBERT WATCHMAN: So -- yeah. So you -- you're -- you disagree with MPI's approach on this.

MS. ANDREA SHERRY: I do.

MR. ROBERT WATCHMAN: Now, but do you agree that accepted actuarial practice in Canada permits derivation of rate indications either with or without making provision for the expected return on investment assets supporting Basic total equity?

MS. ANDREA SHERRY: I don't have the standards in front of me, but my recollection was that it should be the present value of all cashflow related to the -- the book that you are pricing for.

MR. ROBERT WATCHMAN: And so you understand MPI's position?

MS. ANDREA SHERRY: Pardon me?

MR. ROBERT WATCHMAN: And you understand MPI's position with respect to that?

MS. ANDREA SHERRY: I do. I -- I've seen -- I've read -- I believe it was on some of the record, and I've seen the IRs, and I know the PUB asked some question about that, and I asked some questions about that. So it's fairly clear that I don't agree with MPI in terms of the approach in regards to the investment income on the total equity.

MR. ROBERT WATCHMAN: And -- and does your disagreement extend to the point that you would say that what MPI is doing is not within accepted actuarial practice in Canada?

(BRIEF PAUSE)

MS. ANDREA SHERRY: I would hate to say that, because I -- I do believe that the chief actuary at MPI is trying to pra -- follow accepted actuarial practice, but I think it could be a -- a good debate, because if you look at the standards, there is some vagueness there.

MR. ROBERT WATCHMAN: Okay. So --

MS. ANDREA SHERRY: But I would also question why -- you know, why we are having this conversation two (2) or three (3) years later. You know, what the -- what the issue is with including it, I suppose, would be my question.

MR. ROBERT WATCHMAN: Well, so at this point, though, would you say it's a difference -- difference of opinion or difference of preference?

MS. ANDREA SHERRY: I think I would have to go with that. Yeah, difference in opinion. A difference of interpretation.

MR. ROBERT WATCHMAN: If we could turn, Kristen, to page 9 of Dr. Simpson's and Ms. Sherry's report, and the second paragraph.

In the second paragraph, you actually quote from the chief actuary for MPI. It says:

"Without consultation with stakeholders, MPI announced that going forward, the chief actuarial -- actuary will select assumptions that more closely align with the risk appetite of the MPI board of directors, including a 1:100 year, ninety-ninth (99th) percentile outcome level."

Do you recall that?

MS. ANDREA SHERRY: I do. I do, yes.

MR. ROBERT WATCHMAN: And is it your understanding that this statement was made in the context of Basic dynamic capital adequacy testing?

MS. ANDREA SHERRY: It was, yes. It was in response to a question related to that, yeah.

MR. ROBERT WATCHMAN: And is it your understanding as well that if the reserves regulation is not found to be invalid, then the Basic target capital level is not linked to dynamic capital adequacy testing?

MS. ANDREA SHERRY: I do understand that, yes.

MR. ROBERT WATCHMAN: And -- but would you agree -- going back to this statement, would you agree that the use of a ninety-ninth (99th) percentile adverse event modelling assumption for the purposes of dynamic capital adequacy testing is in compliance with accepted actuarial practice in Canada?

MS. ANDREA SHERRY: Again, I would go to the statement that the DCAT, for purposes of private insurance companies -- it's to test your risk of insolvency.

So I would make the same argument I make with the MCT in that, you know, the 1:40 year event for MCT -- or, sorry, DCAT for MPI seemed to be the reasonable level to which we were heading. I don't think they -- if we're going to use DCAT to set the RSR, I think 1:100 would be extreme, very extreme.

MR. ROBERT WATCHMAN: But -- but again, not contrary to accepted actuarial practice in Canada, just a difference in preference.

MS. ANDREA SHERRY: You have to look at the DCAT for -- I -- I'd have to go back and look at the DCAT, because a DCAT is not even required to be done for MPI. MPI is not a federally regulated company, so a DCAT's not required.

So I'm not sure that you could apply the actuarial standards of practice to a DCAT done by a non-federally regulated company. It's their choice to do it, but the government doesn't require them to do it.

MR. ROBERT WATCHMAN: All right.

(BRIEF PAUSE)

MR. ROBERT WATCHMAN: Thank you, Ms. Sherry. Those are all my questions.

MS. ANDREA SHERRY: Thank you.

MR. ROBERT WATCHMAN: Madam Chair, those are all my questions of this part of the panel.

THE CHAIRPERSON: Thank you very much. One moment, please. Mr. Guerra, have you got five (5) minutes' worth of questions?

MR. ANTHONY GUERRA: At this point, I'm just going to reserve the remainder of my questions to Dr. Simpson to tomorrow. Thank you.

THE CHAIRPERSON: Okay. Thank you very much for that. I would like to adjourn now for the evening. What I'm going to ask Board counsel to do is speak with counsel for MPI and for the Interveners. We've got a pretty tight schedule based on the schedule that was agreed to by counsel at the meeting that was held in June, and we need to be able to adhere to it as a result -- we've got a very tight schedule that we need to adhere to, so I'm going to ask Board counsel to have discussions with all other counsel and look at what kind of time frames we can look at to ensure that we're going to complete within time, both in terms of the panel that's going to be presented tomorrow, the remainder of the panel from today, and closing remarks that are scheduled for October 24th. So I would appreciate your cooperation in that.

And with that, we're adjourned until tomorrow morning at nine o'clock. Thank you.

--- Upon adjourning at 4:52 p.m.

Certified correct,

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Cheryl Lavigne, Ms.