MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE CORPORATION (MPI)

2024/2025 GENERAL RATE APPLICATION

HEARING

Before Board Panel:

Irene Hamilton, K.C.- Panel Chairperson

Robert Gabor, K.C. - Board Chair

Susan Nemec - Board Member

George Bass, K.C. - Board Member

Susan Boulter - Board Member

HELD AT:

Public Utilities Board

400, 330 Portage Avenue

Winnipeg, Manitoba

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Pages 1828 to 1972

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--- Upon commencing at 9:02 a.m.

PANEL CHAIRPERSON: Good morning, everyone. Mr. Scarfone, do you have exhibits to enter?

MR. STEVE SCARFONE: Yes, I do, Madam Chair. Thank you for remembering. It's Exhibit -- no, I -- I meant that -- I meant that sincerely. Sorry. I -- I didn't mean anything by that, honestly.

So MPI Exhibit number 104 is response to Undertaking number 17; MPI Exhibit number 105 is response to Undertaking number 13; MPI Exhibit number 106 is response to Undertaking 19; MPI Exhibit 107 is IFRS-14 report by Deloitte, the opinion report that had been filed confidentially initially; MPI Exhibit number 108 is response to Undertaking number 20; and MPI Exhibit number 109 is response to Undertaking number 30.

--- EXHIBIT NO. MPI-104: Response to Undertaking 17

--- EXHIBIT NO. MPI-105: Response to Undertaking 13

--- EXHIBIT NO. MPI-106: Response to Undertaking 19

--- EXHIBIT NO. MPI-107: IFRS-14 Report by Deloitte

--- EXHIBIT NO. MPI-108: Response to Undertaking 20

--- EXHIBIT NO. MPI-109: Response to Undertaking 30

PANEL CHAIRPERSON: Thank you. Ms. McCandless...?

MS. KATHLEEN MCCANDLESS: Thank you.

CONTINUED MPI INVESTMENT/ALM PANEL

CARA LOW, Resumed

GLENN BUNSTON, Resumed

CONTINUED CROSS-EXAMINATION BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: Good morning, Ms. Low, Mr. Bunston. So picking up from where we left off yesterday morning, can we go to slide number 30 from the investments presentation.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Thank you. So the impact of inflation we see here at the third bullet is to be 63.5 million in 2021/'22 and 2022/'23 was 55 million?

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

MS. KATHLEEN MCCANDLESS: Is this the impact of excess inflation, so the amount over 2 percent, or is it the impact of total inflation?

MS. CARA LOW: That would be total expected inflation based on the consensus forecasting from the banks.

MS. KATHLEEN MCCANDLESS: Is this the impact on existing claims or on existing plus new claims?

MS. CARA LOW: On existing claims -- well, existing and known -- claims that have happened in the past, any claims that have happened in the past, so.

MS. KATHLEEN MCCANDLESS: Thank you. Now I'm going to have a look at investment income from the Application compared to the October update. So first, Kristen, can you please go to PF-1 from the Application? And for 2023/'24, we're looking down at line 32.

So first we see investment income for 2023/'24, plus the interest rate impact; that brings us to a forecast of $125.6 million?

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

MS. KATHLEEN MCCANDLESS: And then the forecast for the next fiscal year is $127.2 million?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And $131.9 million in 2025/'26?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And investment income will be primarily from interest on the fixed income portfolio which is sensitive to interest rate changes?

MR. GLENN BUNSTON: Yes, interest income would be the largest component of investment income.

MS. KATHLEEN MCCANDLESS: Now moving to MPI Exhibit number 50 and PF-1 at page -- pardon me, INV-1 at page 18. So this is the October update, and now we see -- I'm looking at line 40, so we'll need to go down a little more. Thank you.

And so 2023/'24 budget, the total Basic line of business investment income is $10.3 million?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: So that's

compared to the 125.6 million we just saw in the Application?

MR. GLENN BUNSTON: Yes. It's significantly lower than we had originally expected due to the fact that interest rates have increased during the year.

MS. KATHLEEN MCCANDLESS: Okay. So if we look at PF-5 from the October update, and page 13 -- thank you.

So this explains the variances from the forecast last -- or at the time of the Application to the October update?

MR. GLENN BUNSTON: Yes, it does.

MS. KATHLEEN MCCANDLESS: And the major change here is at line 17, higher unrealized losses on the fixed income portfolio?

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

MS. KATHLEEN MCCANDLESS: And that's $110.96 million?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: Then line 9, we see higher than expected amortization of 4.2 million?

MR. GLENN BUNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: Interest income of $3.5 million, line 10?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And this is due to the forecast increase in interest rates?

MR. GLENN BUNSTON: Yes. Higher interest rates produce higher interest income.

MS. KATHLEEN MCCANDLESS: At line 16, we see that MPI is forecasting lower than expected private debt gains of $9.3 million?

MR. GLENN BUNSTON: Yes, that's correct. Private debt is -- is a fixed income instrument which is also interest rate sensitive.

MS. KATHLEEN MCCANDLESS: Then if we go to PF-1 from the October update, PF -- this is 1(a). I think we just need to go here. Perfect. Thank you.

And again, looking to line 32, now we see that, for 2024/'25, MPI is forecasting higher levels of investment income from the time of the Application. So we see $134.7 million?

MR. GLENN BUNSTON: That's the projected investment income, yes.

MS. KATHLEEN MCCANDLESS: And the forecast increases for 2025/'26 to $142.2 million?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: If we go to PF-6, which is at page 16, and go to the next -- page 15 -- pardon me -- PF-6.

So this explains the variances for 2024/'25 from the Application to the October update?

MR. GLENN BUNSTON: Yes, it does.

MS. KATHLEEN MCCANDLESS: And here we see at line 8 the higher level of investment income now forecast for 2024/'25 is due to $5.6 million higher than expected amortization?

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

MS. KATHLEEN MCCANDLESS: And $4.95 million higher expected interest income?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: Then offsetting these gains is lower than forecast expected real estate and infrastructure income, so a decrease of $1.9 million?

MR. GLENN BUNSTON: That's right, yes.

MS. KATHLEEN MCCANDLESS: And to what does MPI attribute that decrease?

(BRIEF PAUSE)

MR. GLENN BUNSTON: So our methodology for forecasting income from real estate and infrastructure is based on CPI, plus a spread, and so our forecast of CPI has come down slightly.

MS. KATHLEEN MCCANDLESS: Thank you. Then going back to PF-1 and looking at the forecast for investment income for 2025/'26, which is now $142.2 million.

And that's a change from the original forecast in the Application of $131.9 million?

MR. GLENN BUNSTON: You are looking at '25/'26?

MS. KATHLEEN MCCANDLESS: Yes.

MR. GLENN BUNSTON: Yes, it's 142 here.

MS. KATHLEEN MCCANDLESS: We can go back to PF-1 from the Application if that would help.

At the time of the Application, it was forecast at line 32 $132.9 million?

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

MS. KATHLEEN MCCANDLESS: And to what does MPI attribute that forecast increase?

MR. GLENN BUNSTON: I believe it would be due to higher interest rates. And as fixed income instruments are turned over and new instruments are purchased at the higher yields, that would increase investment income.

MS. KATHLEEN MCCANDLESS: Thank you. Now, still looking at PF-1 but from the October update, and -- pardon me -- if we can go to page 13. There's going to be a bit of jumping around here.

So if we compare the higher than expected loss in marketable bonds at line 17 of $110.9 million, and then if we go to page 11, line 17, we see the -- the far right column for the decrease amount, not the percentage, there is a claims incurred interest rate impact of $65.1 million?

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

MS. KATHLEEN MCCANDLESS: Can you explain why there is a $45 million difference between the two (2) numbers we just compared, so the 110.9 versus the 65.1?

(BRIEF PAUSE)

MS. CARA LOW: Sorry, could you repeat the question.

MS. KATHLEEN MCCANDLESS: So, right

now, we're looking at line 17. The claims incurred interest rate impact is a decrease of $65.1 million.

When we look at PF-5 or -- and the next page, I believe, page 13, pardon me. Yeah.

There's the higher than expected loss on the marketable bonds of $110.9 million. And the question was: What's the explanation for the $45 million difference between those two (2) numbers.

MS. CARA LOW: Okay. Thank you.

(BRIEF PAUSE)

MS. CARA LOW: There's a number of factors. For discounting the liabilities we -- we removed the expected and unexpected credit spread, which is included in your fixed income.

We also were over funded in our liability -- sorry, in our portfolio. And then the other one was that we have commercial mortgages as part of our reference curve for discounting our liabilities, but the commercial mortgages haven't been implemented yet.

I'm trying to think if there was any other ones, but there was at least three (3) differences.

MS. KATHLEEN MCCANDLESS: If MPI is using the forward curve for projecting yield curve movement and not making a naive assumption for discounting claims, how much would this assumption have contributed to the difference?

MS. CARA LOW: I don't have the information readily available. You do have the IR number 20 that was finished and completed, so we could compare those two (2). And when -- we would have that.

MS. KATHLEEN MCCANDLESS: Well, we'll likely do some followup on that --

MS. CARA LOW: Okay.

MS. KATHLEEN MCCANDLESS: -- with the Undertaking panel.

But is this -- so just to follow, if you're able to answer, is this the reason the asset liability matching, including convexity matching, is unable to mitigate this difference?

MS. CARA LOW: The forward rates being in there?

MS. KATHLEEN MCCANDLESS: Yes.

MS. CARA LOW: We're always going to have a disconnect because when we discount, we remove credit spread. So, there's always going to be a disconnect between the assets and liabilities under IFRS-17.

But, yes, there would be a further disconnect because of the -- in the forecasting, 'cause we use a naive assumptions on the asset side, but not on the liability side.

MS. KATHLEEN MCCANDLESS: Similarly, if we look at 2025 -- 2024/'25, so page 14, again, line 17, we see the claims incurred interest rate impact with an increase of $18.4 million, whereas if we go to the investment income interest rate impact, back -- back at PF-1, I believe -- then we see that the -- there's zero (0) there, right, at line 31?

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

MS. KATHLEEN MCCANDLESS: And is that due to this disconnect that we were just talking about as well?

MS. CARA LOW: One minute, the back line is texting here.

(BRIEF PAUSE)

MS. CARA LOW: So, when we look at the mismatch between the assets and liabilities, which is row -- sorry -- I'm lost -- oh, the very bottom one, so, Row 18.

Most of that is going to be from the forward rates, but there's always going to be this disconnect between the credit spread being removed from the discount rate for liabilities but not for investments, but the vast majority of that would be the forward rates in the forecasting.

MS. KATHLEEN MCCANDLESS: There now appears to be a disconnect between the protection that's intended to be generated by the ALM approach of the Corporation?

MS. CARA LOW: Yeah. Under IFRS-17, the discount rate is supposed to reflect the characteristics of the liabilities.

Under IFRS-4, the discount rate reflected the characteristics of the assets backing the liabilities.

So, that was a change. It is a change all insurance companies are seeing. So, there is a disconnect. In the end, though, the discount rate is just a financial reporting consideration, right.

MS. KATHLEEN MCCANDLESS: So, does that mean the ALM is working as intended or not?

MS. CARA LOW: It is working and we do

have -- we've done a lot of work for Q1 of this fiscal year, where we've done a reconciliation. So, we understand all the different components of how things are moving. It is not necessarily reflected on the income statement.

MS. KATHLEEN MCCANDLESS: Okay. Thank you. Now, looking at the transferring of the pension obligation, PUB/MPI-1-127.

MPI is -- so, MPI is currently considering transferring its pension management to the province?

MS. CARA LOW: That is correct.

MS. KATHLEEN MCCANDLESS: And the issue was discussed in last year's GRA and was slated to take place in 2023/'24?

MS. CARA LOW: That is correct. This is handled by our CFO. So, I'm not sure I can answer all the questions.

MS. KATHLEEN MCCANDLESS: Okay. To the extent that you're capable, I'll ask some general questions about this.

So, the change would be from a change of the pay-as-you-go approach to a pre-funding approach for MPI's share of the Civil Service Superannuation Act?

MS. CARA LOW: That's my understanding. Yes.

MS. KATHLEEN MCCANDLESS: And, if we go to MPI Exhibit Number 13 and these are the financial statements for 2022/'23, looking at page 11, thank you.

So we see here that, at Liabilities, MPI has an employee future benefits portfolio and records a pension liability on its books of $328.8 million --

MS. CARA LOW: Correct.

MS. KATHLEEN MCCANDLESS: -- as at March 31, 2023?

MS. CARA LOW: Yes.

MS. KATHLEEN MCCANDLESS: Would that involve transferring the pension assets and obligations to the province?

MS. CARA LOW: Yes.

MS. KATHLEEN MCCANDLESS: And, last year, MPI indicated that -- and we can go to CAC/MPI 1-66.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Perfect, thank you. MPI had indicated that there would be a transition gain. It was estimated at $150 million?

MS. CARA LOW: I see that.

MS. KATHLEEN MCCANDLESS: Is there an update to the estimate of what that transition gain would be?

MS. CARA LOW: I do not have that information.

MS. KATHLEEN MCCANDLESS: So, is there an update or -- or do we know if there has been an update to that number?

MS. CARA LOW: I believe there must be. I would assume there is one.

MS. KATHLEEN MCCANDLESS: So could MPI undertake to advise as to the update in the estimate of the transition gain for the intended transfer of pension management to the province?

MR. STEVE SCARFONE: Yes, we'll take that undertaking, Ms. McCandless.

--- UNDERTAKING NO. 32: MPI to advise as to the update in the estimate of the transition gain for the intended transfer of pension management to the province

MS. KATHLEEN MCCANDLESS: Thank you.

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: The change in the funding method would result in the removal of the assets backing the pension, which would then result in reduced investment income. Is that fair?

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

MS. KATHLEEN MCCANDLESS: Has the -- has the Corporation forecasted how much the investment income would be reduced as a result of the transfer?

MR. GLENN BUNSTON: No, we have not.

MS. KATHLEEN MCCANDLESS: And I understand that, at this time, the Corporation has not made a decision and -- and so the transfer is not reflected in the Application. Is that correct?

MR. GLENN BUNSTON: No, I don't believe that it has been reflected in the Application.

MS. KATHLEEN MCCANDLESS: Thank you. Just a couple things to confirm.

So MPI's investment committee working group is responsible for monitoring the performance of the investment portfolio?

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

MS. KATHLEEN MCCANDLESS: And MPI's review of the investment manager performance is based on the active manager monitoring policy?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: MPI has engaged Element to provide comparison metrics for its portfolios relative to benchmarks?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: Now, if we could go to INV Appendix 14, please, page 5.

This graphic just explains the risks associated with the liabilities. And we see interest rate, inflation risk, liquidity risk, and currency risk?

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

MS. KATHLEEN MCCANDLESS: Can you just elaborate on the liquidity risk and the currency risk exposure faced by MPI?

MR. GLENN BUNSTON: Currency risk exists within our investment portfolio to the extent that we invest in assets that are valued in currencies other than -- than the Canadian dollar, which is primarily our infrastructure investment portfolio, as well as our global equity portfolio.

Our private debt portfolio has some US

exposure, but that is substantially hedged back to the Canadian dollar by the investment manager.

So those are the main currency risks as it relates to the investment portfolio.

MS. CARA LOW: We have a very small number of claims that do come out of the US. If you have your third-party liability exposure, which is at a million -- no, it's at a half-a-million dollars. And you go down to the US and you've injured someone, there could be a claim coming back that's in US dollars. But that would be small for the Basic because that mostly goes through the Extension.

MS. KATHLEEN MCCANDLESS: Okay. And that's liquidity risk?

MS. CARA LOW: No, that would be currency risk.

MS. KATHLEEN MCCANDLESS: Currency, okay. And with respect to liquidity risk, are you able to elaborate?

MR. GLENN BUNSTON: Liquidity risk relates to the cost to liquidate investments when cash is required by the business.

Our Basic claims investment portfolio is -- is highly liquid. It's interested in provincial bonds; is the largest portion of the Basic claims investment portfolio. Those bonds are highly liquid. They have relatively tight bid ask spreads and, therefore, can be sold quickly and easily with minimal cost.

We also have corporate bonds. They are slightly less liquid, slightly higher bid ask spreads but can also be liquidated if and when necessary.

We also have cash and short-term investments, which are highly liquid.

So, we have a significant amount of liquidity and a minimal amount of liquidity is -- is generally required from our business. But we do occasionally need to make transfers from -- from our retained earnings portfolio to our corporate cash account. And when we do that, we liquidate the more liquid investments within the RSR portfolio.

MS. KATHLEEN MCCANDLESS: Are these two (2) risks addressed through the ALM?

MR. GLENN BUNSTON: Yes. The ALM study considers currency risk and liquidity risk.

MS. KATHLEEN MCCANDLESS: Who manages or monitors these two (2) risks, liquidity and currency?

MR. GLENN BUNSTON: Well, my team does in conjunction with our financial reporting team to ensure that we have the liquidity and cash on hand to -- to pay claims and other expenses as they arise.

MS. KATHLEEN MCCANDLESS: So no outside manager for those risks?

MR. GLENN BUNSTON: No outside manager, no.

MS. KATHLEEN MCCANDLESS: Then moving to page 6, is it fair to state that the most significant risk for MPI related to its claims liabilities is interest rate changes?

MS. CARA LOW: No. I would say there's many risks related to our claims 'cause we have the interest rate risk, we also have the inflation risk because of the indexation to Manitoba CPI for some of the PIPP benefits, but we also have reserve risk which ties in to mortality and how long these claimants may stay on reserves -- or on payments, right.

And so therefore, we don't know how much money to put away 'cause we don't know if we're going to be providing payments for twenty (20) years, forty (40) years, sixty (60) years. So there's a lot of risks involved in our unpaid claims.

MS. KATHLEEN MCCANDLESS: But is interest rate risk not the largest risk from a financial standpoint?

MS. CARA LOW: From a financial standpoint? Well, from an investment standpoint.

MS. KATHLEEN MCCANDLESS: And the asset-liability management is primarily focussed on addressing interest rate risk?

MS. CARA LOW: Correct.

MS. KATHLEEN MCCANDLESS: Now, if we could go to Figure INV-43 from the Application.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: So interest rate risk is reflected in this table, and the major exposure to changes in interest rates is pronounced in the claims portfolio and the employee future benefit portfolio?

It's not necessarily in this -- in this table here, but I will have some questions about what's in the table specifically.

MR. GLENN BUNSTON: Sorry, could you rephrase your question?

MS. KATHLEEN MCCANDLESS: Sure. So this table reflects that MPI's exposure to inflation rate changes is pronounced for the Basic claims portfolio and the employee future benefit portfolio?

MR. GLENN BUNSTON: I believe that this table refers to --

MS. KATHLEEN MCCANDLESS: Pardon me.

MR. GLENN BUNSTON: -- interest rate risk.

MS. KATHLEEN MCCANDLESS: Yes.

MR. GLENN BUNSTON: And significant interest rate risk exists within our Basic claims liabilities and within the employee future benefits liabilities by virtue of the fact that they have much longer durations than the liabilities in the other lines of business.

MS. KATHLEEN MCCANDLESS: We see a description for the 2023 GRA and the 2024 GRA, and if we look at lines 4 and 8, we see that there has been an increase in the net income impact?

MR. GLENN BUNSTON: Yes. We see an increase in the projected impact.

MS. KATHLEEN MCCANDLESS: And can you explain the reason for that increase?

(BRIEF PAUSE)

MR. GLENN BUNSTON: I believe it's due

to the fact that forward rates are now used under IFRS-17 to discount the liabilities, and on the asset side we were using naive interest rate assumptions.

MS. KATHLEEN MCCANDLESS: Thank you. And are there any inflation impacts for the Extension SRE and/or RSR portfolios?

MS. CARA LOW: None of the benefits in Extension or SRE are linked to inflation. We do continue to see collision severity rise because of severity, but nothing's linked to CPI, no.

MS. KATHLEEN MCCANDLESS: Thank you. And just to -- just for completeness sake, inflation risk is the risk of the value of the assets and liabilities are mismatched because of the different impacts of inflation on assets and liabilities, fair?

MS. CARA LOW: Yes.

MS. KATHLEEN MCCANDLESS: Then if we go to PUB/MPI-2-29. And this is a graph showing breakeven inflation through August 31, 2023, starting at the end of 2021?

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

MS. KATHLEEN MCCANDLESS: And so can, first of all, MPI explain what a breakeven inflation rate is?

MR. GLENN BUNSTON: Yes. Breakeven inflation rate is the market's expectation of future inflation, so it's calculated as the difference in the -- the yield on a nominal federal bond and the yield on a real return bond -- federal real return bond of the same term and duration.

MS. KATHLEEN MCCANDLESS: And why is MPI monitoring, or modelling, breakeven inflation?

MR. GLENN BUNSTON: Well, breakeven inflation is going to be the basis of how we set our reserves for inflation once the bond overlay strategy is in place.

And the bond overlay strategy will produce gains or losses to the extent that actual inflation differs from the breakeven inflation rate.

So, it will be the determinant of the gains and losses generated by the bond overlay strategy.

MS. KATHLEEN MCCANDLESS: So, when we're looking at the graph, we see the blue line is the five (5) year breakeven inflation rate, orange is the ten (10) year breakeven inflation rate, grey is the thirty (30) year breakeven inflation rate, and then the yellow line is CPI?

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

MS. KATHLEEN MCCANDLESS: And can you explain what is being reflected in this graph with respect to actual inflation?

MR. GLENN BUNSTON: Well, first of all, you can't directly compare CPI to the breakeven inflation rates because the breakeven inflation rates are forward-looking expectations of inflation, while CPI is actual realized inflation on -- on these dates.

And again, these are expectations the -- of inflation five (5) years into the future, ten (10) years into the future, and thirty (30) years into the future.

And we see that for the longer inflation expectation line, it's -- the grey one, it's less volatile generally and more stable than the shorter term inflation expectations, and with the -- the five (5) year being the most volatile.

MS. KATHLEEN MCCANDLESS: And for MPI, what inflation risk, with reference to this graph, is it most focussed on?

MR. GLENN BUNSTON: Well, we're focussed on the risk that actual inflation differs from our inflation expectations and our inflation reserves.

MS. KATHLEEN MCCANDLESS: And so the

goal of the ALM with respect to managing inflation risk is to reduce volatility, so producing asset gains that'll offset actuarial liability losses?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And so that's -- that -- to offset actuarial liability losses when actual inflation exceeds the inflation assumption?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And to produce asset losses which will offset actuarially -- actuarial liability gains, when the actual inflation is less than the assumed inflation rate used by the actuary.

MR. GLENN BUNSTON: That will be an outcome of the strategy. Yes.

MS. KATHLEEN MCCANDLESS: And, if we go to CAC/MPI-1-74, page 2, at 'B', references an actuarial inflation assumption?

It's just there for reference, so you see an -- a reference to the actuarial inflation assumption here?

MR. GLENN BUNSTON: Yes. I see that.

MS. KATHLEEN MCCANDLESS: And what is the assumed inflation rate used by the actuary?

MS. CARA LOW: Currently, without a bond overlay strategy, we're using the bank consensus forecasting for the expected inflation. Under a bond overlay strategy, it would be reduced and we would use a long term break-even rates, for the percentage of the hedge ratio.

MS. KATHLEEN MCCANDLESS: And, so, the response here indicates that the actuarial inflation assumption should be aligned with the long term break-even rates, and that the de-risking strategy remains effective at reducing surplus volatility, whether the actual inflation is above or below the breakeven or actuarial inflation rates?

MS. CARA LOW: Correct.

MS. KATHLEEN MCCANDLESS: Yes. Can you explain how, or provide an example of how a variance from this scenario would affect MPI?

MR. GLENN BUNSTON: Could you clarify a variance in -- in which way?

MS. KATHLEEN MCCANDLESS: So, some deviation from what the intended de-risking strategy is producing, or what the intent of the de-risking strategy is.

MR. GLENN BUNSTON: Well, I think the risk would be, if our actuarial -- if our inflation assumption for reserving purposes was something other than the breakeven inflation rate, because then there would be what -- what we would call basis risk between the gains or loss generated on the bond overlay strategy and our inflation reserves.

So that's why it's important that the -- the reserves and the inflation rate used to determine those reserves is set to equal the breakeven inflation rate.

MS. KATHLEEN MCCANDLESS: Thank you. Now, moving on to the composition of the portfolio and the Mercer ALM recommendations.

Can we go to -- perfect -- this is from the compliance with Board Orders section of the filing and appendix 3. And this is material that's been -- that was submitted to the Investment Committee on February 9, 2023.

If -- and then, if we can go to page 30 -- 83, pardon me, of this -- just to confirm, Mercer used an efficient frontier analysis in a step-wise fashion.

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

MS. KATHLEEN MCCANDLESS: And new asset classes for evaluation of each of the portfolios against return metrics?

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

MS. KATHLEEN MCCANDLESS: And the pyramid that we see here, on the screen, reflects each of the new -- the different new asset classes that were introduced in the set -- step-wise fashion to evaluate their introduction into the portfolio?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: The asset classes that we see in green, on the screen, were the new asset classes introduced for evaluation?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And we have three (3) efficient frontiers, Efficient Frontier 1, so real return bonds were used?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And Efficient Frontier 2, commercial mortgages and real estate were used?

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

MS. KATHLEEN MCCANDLESS: And then Efficient Frontier 3, there's the introduction of three (3) times long term provincial bonds, three (3) times real return bonds, Canadian equity, global equity and all country world equity?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And, Mercer recommended portfolio based on the Efficient Frontier Asset Mix, which was 'D'.

I think if we go down -- down the page, we'll get to 'D' shortly.

But, subject to check, you -- Mercer had recommended a grouping of 'D'.

MR. GLENN BUNSTON: I believe so. It was the, what we call, the mid-point, so it was a reduction of risk and an increase in return relative to our current portfolio.

MS. KATHLEEN MCCANDLESS: Okay. And, if we go to page 12, here -- oh wait, right. There we have it.

So, for the -- the -- under Recommendations, the second paragraph here, it says, for the long-term basic claims portfolio there's a -- a recommendation and it's an Asset Mix 'D'?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And, then, can we go down here. So, page 13, this is Efficient Frontier Number 3-4, Basic Claims Portfolio, and it's an illustration of the different mixes. We have 'A', 'B', 'C', 'D', and 'E'?

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

MS. KATHLEEN MCCANDLESS: And can you just explain, at a high level, what the selection of Portfolio 'D' does for MPI?

MR. GLENN BUNSTON: Yes. So, our current portfolio is labelled as Portfolio 'A' and you can see that the Efficient Frontier is above our current portfolio, which means there are asset mixes that have either less return or -- sorry -- less risk or more return or both and Portfolio 'D' is the one that was selected and -- and recommended and, so, it has less risk and more return than the current portfolio.

MS. KATHLEEN MCCANDLESS: So, addition of new asset classes. So, moving from 'A' to 'D' would result in a -- or should result in a higher overall return with less risk?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And, then, can we just go back to page 12 and the Recommendations.

So, we were just speaking about Asset Mix 'D' for the long-term Basic claims portfolio and -- but the first recommendation made by Mercer was to establish a Basic short-term portfolio to back short-term claims?

MR. GLENN BUNSTON: Well, this was a recommendation written by my team that was, then, submitted to the -- to the Investment Committee.

MS. KATHLEEN MCCANDLESS: Pardon me. So, it was a rec -- recommendation made by management at MPI?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And I believe we had heard yesterday that, ultimately, MPI chose not to implement the Basic short-term portfolio?

MR. GLENN BUNSTON: Yes. That's right.

MS. KATHLEEN MCCANDLESS: Now, can we go down to page 14. Thank you. So, this figure shows the asset mixes identified on Efficient Frontier Number 3.

So, the mixes that are reflected in the graph that we were just looking at a moment ago?

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

MS. KATHLEEN MCCANDLESS: And, looking at the Mid-point 'D', so, that's the one that was selected, we see fixed income at 85 percent?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And that includes 34 percent for inflation-protected bonds or Real Return Bonds?

MR. GLENN BUNSTON: Right.

MS. KATHLEEN MCCANDLESS: Fifteen percent in alternative investments, consisting of commercial mortgages and real estate?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And if we look at the modelling of the information ratio, so -- and we're looking at -- under Risk Metrics, third line down, there's something called Information Ratio, Excess Return/Risk?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And, so, can you explain what that is?

MR. GLENN BUNSTON: So, it's a risk-adjusted measure of return. It's the, as it indicates there in brackets, it's the expected excess return divided by the risk which, in this case, is defined by -- as -- by surplus volatility.

MS. KATHLEEN MCCANDLESS: So, a higher number would be better?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And we see

the current information ratio at the time of this recommendation was point two (.2) and the mid-point then increases it to point four five (.45)?

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

MS. KATHLEEN MCCANDLESS: And probability of deficit at 10 years, can you just explain what that means?

MR. GLENN BUNSTON: Yeah. It means the probability of -- of a negative net income, I guess, I think, at any point over a 10-year period.

MS. KATHLEEN MCCANDLESS: And, so, for that metric, obviously, a lower number is better?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And we see the Current at 'A' was 26 percent and, with Mid-point 'D', it's reduced to 13 percent?

MR. GLENN BUNSTON: That's right.

MS. KATHLEEN MCCANDLESS: And then, the expected excess return at ten (10) years -- so the first line just under 'Risk Metrics' -- increases from .72 percent to 1.09 percent?

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

MS. KATHLEEN MCCANDLESS: And the selected portfolio has a lower surplus volatility so it goes from 3.65 percent to 2.4 percent?

MR. GLENN BUNSTON: Correct.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Now we're looking at the minimum capital required at figure 2. So -- and that's under 'Other Metrics'.

Under the current -- or 'A' portfolio, the minimum capital required was $15.6 million. And that increases to $72.4 million with portfolio 'D'.

Yes?

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

MS. KATHLEEN MCCANDLESS: So notwithstanding the lower risk and potential for higher returns, the MCT still requires a higher level of capital to move from portfolio 'A' to 'D'?

MR. GLENN BUNSTON: Yes, it does.

MS. KATHLEEN MCCANDLESS: And can you explain why?

MR. GLENN BUNSTON: Yes. Because the addition of commercial mortgages and real estate attract higher capital charges as determined by -- by OSFI of, I believe, 10 percent for mortgages and 20 percent for real estate.

Whereas, government bonds have either -

- federal bonds, I believe, have zero risk capital charges and provincial bonds have capital charges of 3 to 4 percent, I believe. So there's higher returns from the mortgages and real estate, but they have higher capital charges.

MS. KATHLEEN MCCANDLESS: And so, the selection of the proposed asset mix at 'D' then has an impact on the MCT score? We can go to page 39 of this appendix for reference.

So we see here, at the first bullet on the screen, that asset mix 'D' has the second lowest required capital of the proposed asset mixes. But the MCT ratio is projected to fall from one-point -- 105.6 to 98.5 percent?

MR. GLENN BUNSTON: Yes, that's what's written on the screen.

MS. CARA LOW: Just as a clarification, this is not a full minimum capital requirement calculation. It was just a very simplified methodology in order to look relative to each of the options, right.

MS. KATHLEEN MCCANDLESS: Right. So just -- the point is that more capital is required. That has an impact on the MCT ratio and we see it here, reflected in this document. Correct?

MS. CARA LOW: Correct.

MS. KATHLEEN MCCANDLESS: Now, can we go to CAC/MPI-1-86? And we'll start at page 4.

So when Mercer models a portfolio with a lower surplus volatility and higher information ratio from the existing portfolio, that, in turn -- does that mean that there's lower risk to MPI?

MR. GLENN BUNSTON: Yes, it means there's lower economic risk.

MS. KATHLEEN MCCANDLESS: And so, then the MCT calculation does not correlate with changes in surplus volatility?

MR. GLENN BUNSTON: Not necessarily. As Mercer explained in their response, I believe, to this IR, the MCT risk charges do not necessarily reflect the -- the correlations between asset classes and the fact that they might be lower. And that there are some asset classes that help to reduce risk and surplus volatility, in particular. But their -- their capital charges don't reflect that.

MS. KATHLEEN MCCANDLESS: And just scrolling down to the response to 'B', just following up on the charges for commercial mortgages and real estate, there's a reference here to an outsized MCT charge. On the last line.

That those asset classes attract an outsized MCT charge.

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

MS. KATHLEEN MCCANDLESS: Can you explain what is meant by 'outsized'?

(BRIEF PAUSE)

MR. GLENN BUNSTON: Well, I think what they mean by 'outsized' is that commercial mortgages and -- and real estate help to diversify the portfolio. And so, they can reduce risk from a surplus volatility perspective.

But despite that fact, the capital charges are significantly higher than fixed income asset classes at 10 percent for commercial mortgages and real estate -- I said 20 percent earlier, but actually it's 30 percent if it's not a direct investment in a -- in a real property.

MS. KATHLEEN MCCANDLESS: Thank you. Now, can we go back to Appendix 3, from the compliance, page 88.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: So Mercer had modelled a proposed asset mix against inflation scenarios. Correct?

MR. GLENN BUNSTON: Yes, they considered a number of scenarios related to inflation.

MS. KATHLEEN MCCANDLESS: And so, we see that the -- in the narrative paragraph here, there's an allocation to real return bonds, reducing inflation risk and, therefore, surplus volatility?

MR. GLENN BUNSTON: Yes, that's what it says.

MS. KATHLEEN MCCANDLESS: And did the introduction of alternative investments provide enhanced inflation protection or is it just the introduction of the real return bonds that does so?

MR. GLENN BUNSTON: The real estate investments have the possibility to add some inflation protection. It's not a direct linkage. And so, it depends on the type of real estate purchased and -- and whether, for example, rent paid on the -- on the property is linked to increases in inflation. So it's very property specific. But real estate can have some inflation hedging properties, yes.

MS. KATHLEEN MCCANDLESS: Going down to page 90, and now we're looking at what had been recommended as the Basic short portfolio.

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

MS. KATHLEEN MCCANDLESS: Scrolling down. And that asset mix would have been cash -- cash equivalents of 88 percent, mortgages of 10 percent, and mid-term provincial bonds?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And we had heard yesterday, I believe, that there would be a 9 percent allocation to the Basic short-term portfolio had it been adopted?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And that's because it would represent the portion of claims to cover short-tail liabilities such as property damage, collision, and comprehensive?

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

MS. KATHLEEN MCCANDLESS: And because of the short-tail to settled these types of claims, then MPI's inflation exposure is not as significant as it is with a long-term portfolio?

MR. GLENN BUNSTON: Could you repeat the question?

MS. KATHLEEN MCCANDLESS: So because there's a shorter tail for claims such as property damage, collision, and comprehensive, the inflation risk to MPI is -- or the inflation exposure is not as great as it would be in a long-term portfolio?

MS. CARA LOW: That would be true because we can adjust the rates once a year to reflect the higher severity costs coming through.

MS. KATHLEEN MCCANDLESS: And liquidity would be a higher priority then?

MS. CARA LOW: Yes.

MS. KATHLEEN MCCANDLESS: And we also heard that the investment -- or the MPI Board did not go with a Basic short portfolio.

Can we go to PUB/MPI-1-8. So the question was when the decision was made to not implement the short-term Basic portfolio. And there's the response here.

So the investment committee recommended that the Board of Directors approve the asset mix that had no short or long-term split on February 16.

And the decision was made because the additional portfolio would create additional work and expenses with no benefit?

MS. CARA LOW: Correct.

MS. KATHLEEN MCCANDLESS: The majority of short-term claims are paid out of operating cash?

MS. CARA LOW: Correct.

MS. KATHLEEN MCCANDLESS: Can you just elaborate on what additional work and cost would have been required for a Basic short portfolio?

MR. GLENN BUNSTON: Well, there would have been additional accounting and reporting requirements to -- to create a new portfolio and to report on it, and as well as work for the -- my team to monitor it and make sure that there were sufficient funds within it and that the funds were moved back to the operating cash account so -- when they were needed to pay claims; and finally, additional work on the part of the Province of Manitoba which manages and purchases the actual short-term investments for us.

MS. KATHLEEN MCCANDLESS: Did MPI assess the extent to which a portfolio change would change the discount rate?

(BRIEF PAUSE)

MS. CARA LOW: No, we did not, but we also moved to the premium liability duration for that exact reason, right? Because if you're paying cash out, it's not sitting on your balance sheet and you're not getting the support from the Basic claims investment portfolio.

MS. KATHLEEN MCCANDLESS: Thank you. Now, moving to the RSR and EFB portfolio mixes. So first, let's go to page 30 of COM Appendix 3.

And so this graphic here shows the efficient frontier in the asset classes for the RSR portfolio?

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

MS. KATHLEEN MCCANDLESS: And Mercer was modelling the inclusion of additional returns seek -- seeking assets such as All Country World Equity, global, small cap, and multi-asset credit?

MR. GLENN BUNSTON: I believe this Efficient Frontier shows current asset classes only.

MS. KATHLEEN MCCANDLESS: Yes, but Mercer had modelled other asset classes?

MR. GLENN BUNSTON: It did model other asset classes, yes.

MS. KATHLEEN MCCANDLESS: And Mercer considered interest rate sensitive assets of commercial mortgages and direct lending?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: MPI, ultimately, did not accept All Country World Equity or commercial mortgages in the recommended portfolio?

MR. GLENN BUNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: MPI selected the midpoint portfolio 'D' for this portfolio?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And has this improved returns?

MR. GLENN BUNSTON: Well, we're only six (6) months into the year, so I think it's a little early to make that assessment.

MS. KATHLEEN MCCANDLESS: And MPI has done a 50/50 split with a 16 percent allocation to global low-volume equity and core Canadian real estate. Is that right?

MR. GLENN BUNSTON: Well, we have a 16 percent -- in -- in portfolio 'D', there's a 16 percent allocation to global low-volatility equities and a 16 percent allocation to real estate, but they are different asset classes, so they both have the same allocation.

MS. KATHLEEN MCCANDLESS: And, sorry, I should have said volatility, not volume. Now, if we go down to -- or, sorry, we can stay here.

So the new portfolio mix lowers public equities from 35 percent of the portfolio to 28 percent?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And then it removes global equities large cap from the mix and reallocates those proceeds among equities and increases the investment in alternatives?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And that's where we see the current 'A' from 35 moves to 50 percent?

MR. GLENN BUNSTON: Yes. Alternatives increase from 35 to 50 percent, yes.

MS. KATHLEEN MCCANDLESS: Now, if we could go to Figure INV-48, and this shows the RSR asset allocation?

MR. GLENN BUNSTON: Yes, it does.

MS. KATHLEEN MCCANDLESS: Focussing on -- can we just scroll down here to the percentages. Perfect. Thank you.

So the allocation to global equities is -- at 2023/'24, we see 7.9 percent, and global low-volatility equities also 7.9 percent?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And this is a departure from what Mercer recommended?

MR. GLENN BUNSTON: Well, what you saw

in the previous slide was an initial analysis that Mercer completed. Subsequent to that, we asked Mercer to complete an analysis of a portfolio that retained exposure to global equities and to large cap Canadian equities, which they did.

And they found that that allocation was marginally inferior to the allocation with -- without the large cap equities. And that -- so that was what was recommend -- ultimately recommended to our investment committee.

MS. KATHLEEN MCCANDLESS: And if we can go to INV Appendix 12, page 21, I think that provides a rationale here for retaining allocation to large cap equities for non-Basic portfolios?

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

MS. KATHLEEN MCCANDLESS: And again, this was a recommendation made by your team?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And do you know where on the Efficient Frontier this mix would put MPI relative to what was modelled by Mercer?

MR. GLENN BUNSTON: Well, as it indicates here, it's -- the mix was slightly below the Efficient Frontier.

MS. KATHLEEN MCCANDLESS: And that's

where we see the information ratio falling from point four two (.42) to point three nine (.39)?

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

MS. KATHLEEN MCCANDLESS: Okay. MPI nonetheless believes that there are diversifi -- diversification benefits to retaining the exposure to large cap equities?

MR. GLENN BUNSTON: Correct.

(BRIEF PAUSE)

MS. KATHLEEN MCCANDLESS: Now, with respect to the employee future benefit asset mix, your team proposed a status quo allocation?

MR. GLENN BUNSTON: Status quo in that we didn't recommend the addition of any new asset classes.

MS. KATHLEEN MCCANDLESS: So no changes?

MR. GLENN BUNSTON: Well, I believe that we re-balanced within the existing asset classes, but we didn't include any new asset classes.

MS. KATHLEEN MCCANDLESS: Okay. And if we go to page 32 of COM Appendix, that's where we see the Efficient Frontiers for the employee future benefits portfolio?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And then the red here says, 'Status quo'. So some re-balancing, but no new asset class. Is that what you said?

MR. GLENN BUNSTON: That's correct.

MS. KATHLEEN MCCANDLESS: And the recommended portfolio was 'E'?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: Portfolio 'D' --

MR. GLENN BUNSTON: Sorry. Just to clarify, I believe "status quo" referred to the issue of whether the pension was to be transferred to the Civil Service Superannuation Board or not, and in this case, "status quo" meant that that transfer was not happening.

MS. KATHLEEN MCCANDLESS: Okay. Thank you. Looking at the information ratio under risk metrics, portfolio 'D' had a higher information ratio, so point four two (.42) versus what was selected at 'E', which was point three nine (.39)?

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

MS. KATHLEEN MCCANDLESS: Can you explain why MPI chose a portfolio with a higher level of surplus volatility and a lower information ratio?

MR. GLENN BUNSTON: Well, when completing an asset liability management study, it's highly dependent upon assumptions made and the accuracy of those assumptions, so expected returns, expected volatility and correlations are critical.

And I think a certain amount of judgment is -- is required when making decisions, so relying 100 percent on those assumptions is not always -- does not always lead to the best outcomes.

In this case, this analysis showed that the selected portfolio 'E' was slightly below the Efficient Frontier and the information ratio was slightly lower.

But our -- our opinion is that by having four (4) equity managers rather than two (2), there's diversification benefits from a manager perspective and also diversification benefits from the perspective that we have exposure to different types of equities rather than just the small cap Canadian equity and the global low volatility.

And so we asked Mercer to evaluate this. And their response -- I believe there was an IR on this -- indicated they thought that was a reasonable decision.

MS. KATHLEEN MCCANDLESS: Thank you. At figure INV 50 -- perfect. Thank you. So this is the employee future benefit asset allocation.

And looking at line 12 -- line 13 for 2024/'25, that portfolio is valued at $602.7 million?

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

MS. KATHLEEN MCCANDLESS: What would happen to the portfolio, so how much of it would have to be transferred to the province, if MPI were to receive that transfer that we were talking about at the outset today?

(BRIEF PAUSE)

MS. CARA LOW: We believe this a question that's better posed to our CFO.

MS. KATHLEEN MCCANDLESS: The undertaking that you gave earlier about updating that $150 million calculation, within that, likely there would need to be some analysis that would provide an answer to my question. Is that fair?

MS. CARA LOW: That would be fair.

MS. KATHLEEN MCCANDLESS: Okay. So maybe just to clarify, to add to the undertaking, if not already answered by the previous undertaking, to just explain the extent to which the -- the EFB investment portfolio would change if MPI were to transfer management to the province.

MR. STEVE SCARFONE: Yes, Ms. McCandless. And on that earlier undertaking I was advised by Ms. Low that we're not aware of how often that is updated on the pension issue, so we'll -- we'll make that inquiry, but it could be that that information's not available.

MS. CARA LOW: The assets would be. It's the liability side, so we have our pension actuary reviewing it. I'm not sure how often he does his review, so I'm not sure we would have an update on the liabilities, only on the asset side, so -- but you still could get a difference, the updated difference.

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: Thank you. Now with respect to Mercer's inflation modelling and at COM Appendix 3, page 87. And we can scroll down a little bit. That's great. Thank you.

So it's noted here that Mercer had modelled three (3) different stress tests of inflation?

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

MS. KATHLEEN MCCANDLESS: And just paraphrasing. So the financial repression scenario is represented by strong growth and inflation supported by -- supported long term by low central bank rates and designed to reduce debt?

(BRIEF PAUSE)

MR. GLENN BUNSTON: Sorry, that's for the financial repression?

MS. KATHLEEN MCCANDLESS: Yes.

MR. GLENN BUNSTON: I don't see that on the screen.

MS. KATHLEEN MCCANDLESS: Well, what's on the screen here, we'll -- we'll take it for what's modelled. So it shares similarities with the ten (10) years following World War II.

And the last time government debt was at today's level, in both cases, an adverse external event, so war and pandemic, required large government outlays. Rather than repaying the debt with higher taxes, it is monetized by central banks holding rates low in spite of sustained high inflation which supports overall growth?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: Then pandemic stagflation. This is referred to as the severe bear case. It captures the most worrisome -- worrisome inflation impact?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And an overheat scenario that incorporates the classic reaction function of central banks tightening policy preemptively to avoid runaway inflation, which has often triggered recessions in the past?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: So Mercer modelled the impact, again, using their base scenario of these three (3) alternative inflation stress tests and the impact on the overall forecast of returns?

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

MS. KATHLEEN MCCANDLESS: In each of the three (3) modelled scenarios with real return bonds in the claims portfolio, the surplus returns improved in each case over a ten (10) year period?

We can scroll down if --

MR. GLENN BUNSTON: -- have a reference --

MS. KATHLEEN MCCANDLESS: -- some reference.

MR. GLENN BUNSTON: Could you repeat the question.

MS. KATHLEEN MCCANDLESS: So I'm just confirming that in each of the three (3) modelled scenarios where real return bonds were included in the claims portfolio, the surplus returns improved over a ten (10) year period.

MR. GLENN BUNSTON: I believe that's true, yes.

MS. KATHLEEN MCCANDLESS: And can we scroll down some more, please, Kristen. Keep going.

So here we have the -- the scenarios that are modelled. First, we see surplus financial repression scenario, then pandemic stagflation scenario?

MR. GLENN BUNSTON: Correct, yeah.

MS. KATHLEEN MCCANDLESS: And the overheat scenario?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: And it looks that the -- to be that the pandemic stagflation scenario results in the largest net reduction from base for the portfolios. And we can just scroll up one (1) page to see that. We're looking at the difference between the red line and the blue line.

MR. GLENN BUNSTON: So the red line is the recommended portfolio, and it shows that the surplus is less negative for the recommended portfolio than for the current portfolio in this stagflation scenario.

MS. KATHLEEN MCCANDLESS: Under each of the scenarios modelled there, it does indicate that there is some requirement for inflation -- inflation protection for the Basic claims portfolio?

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

MS. KATHLEEN MCCANDLESS: On the basis of the work that Mercer prepared, then your team recommended the inclusion of real return bonds --

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: -- Basic claims? If we look at the financial repression scenario and page 93 of the PDF. And scroll down some more.

So the financial repression scenario caused a reduction for the Basic portfolio, but for Extension and SRE, little to no difference, right, if we're looking at these graphs?

MR. GLENN BUNSTON: Could you just scroll --

MS. KATHLEEN MCCANDLESS: Scroll up.

MR. GLENN BUNSTON: -- up a little bit. Okay.

MS. KATHLEEN MCCANDLESS: The lines are -- are fairly close together relative to the Basic portfolio?

MR. GLENN BUNSTON: The recommended portfolio's relatively close to the current portfolio, yes.

MS. KATHLEEN MCCANDLESS: And can you explain why there is only a marginal impact on the Extension and SRE portfolios, as modelled here, versus Basic under the -- the inflation scenarios?

(BRIEF PAUSE)

MS. CARA LOW: Would you mind repeating the question?

MS. KATHLEEN MCCANDLESS: Can you explain the reason why we see in each of the inflation scenarios for the Basic claims, the -- there's a significant impact versus the SRE and Extension portfolios here where we see the lines, the blue and red lines are fairly close together.

MS. CARA LOW: We believe this is due to the indexation of the PIPP benefits and the claims, Basic claims reserves. And we don't have that same indexation in the SRE or Extension.

MS. KATHLEEN MCCANDLESS: Thank you.

MR. GLENN BUNSTON: Just, if I could add to that, also for the Basic claims portfolio we added three (3) new asset classes, so real estate, mortgages and real return bonds, whereas in these portfolios we simply reallocated amongst the existing asset classes. So the changes to the mix is less significant.

MS. KATHLEEN MCCANDLESS: Thank you. Now on moment matching, just to confirm, so the Corporation employs moment matching to manage interest rate risk associated with the Basic claims liabilities?

MR. GLENN BUNSTON: Correct.

MS. KATHLEEN MCCANDLESS: And that was effective as of April 1 of this year?

MR. GLENN BUNSTON: No, moment matching was implemented with the assistance of Addenda.

(BRIEF PAUSE)

MR. GLENN BUNSTON: I believe it was implemented in the summer of 2021, with the assistance of Addenda.

MS. KATHLEEN MCCANDLESS: Okay. Thank you. But at least as of April 1 of this year, the Corporation has adopted IFRS-17 and the liability cash flows will be discounted using a reference portfolio?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: Now, if we could go to PUB/MPI-1-31 and the question at 'A', was to provide a schedule supporting calculations for the benefit to Basic of the moment matching strategy.

$7.7 million for Basic claims on changes in interest rates to March 31, 2023 and, if we go to the response to 'A', we see that as of March 31st, the moment matching strategy had a -- a negative $7.7 million impact, made up of two (2) components, marketable bond gain/loss and decrease in claims incurred due to discount rate change.

And this is the calculation. Figure 1 for marketable gain and loss and figure 2, the claims incurred decrease?

MR. GLENN BUNSTON: Yes.

MS. KATHLEEN MCCANDLESS: The calculation at March 31 for marketable gain, includes both realized and un-realized gains?

MR. GLENN BUNSTON: It does.

MS. KATHLEEN MCCANDLESS: Does this change in investment income reflect the impact of MUSH bonds, which are now held at fair value through profit and loss?

MR. GLENN BUNSTON: Could you scroll up, please. No, I don't believe it reflected the market value of MUSH bonds, since this was at March 31st, and the MUSH bonds were re-stated to market value at -- on April 1st.

MS. KATHLEEN MCCANDLESS: Thank you. Now, just back to the decision to purchase real return bonds. And could we go to PUB/MPI-2-18. The response at B-2.

This is just a reference to the December 22 purchase of $84.4 million of real return bonds. What date did MPI make a decision to purchase real return bonds?

MR. GLENN BUNSTON: I believe it was in early December of 2022.

MS. KATHLEEN MCCANDLESS: Was real return bonds part of the Investment Policy Statement prior to then?

MR. GLENN BUNSTON: They are allowed by virtue of the fact that they are a government bond and they're one -- one of the listed asset classes.

So, while real return bonds are not explicitly called out, they are issued by the federal government and, therefore, they are an approved asset class.

MS. KATHLEEN MCCANDLESS: Thank you. All right, thank you.

Madam Chair, I think it's an appropriate time for a break. I may be finished but I may have two (2) or three (3) questions after the break. I just need to confirm with advisors.

PANEL CHAIRPERSON: Okay. Thank you, Ms. McCandless.

We'll be back, please, at quarter to 11:00.

--- Upon recessing at 10:30 a.m.

--- Upon resuming at 10:46 a.m.

PANEL CHAIRPERSON: Ms. McCandless, do you have any further questions?

MS. KATHLEEN MCCANDLESS: Just maybe

another minute. Thank you.

CONTINUED BY MS. KATHLEEN MCCANDLESS:

MS. KATHLEEN MCCANDLESS: MPI uses Addenda for their IFRS-17 yield curve approach to claims liabilities?

MR. GLENN BUNSTON: Yes, Addenda calculates and produces the IFRS-17 discount curve.

MS. KATHLEEN MCCANDLESS: And was one of the reasons for using this approach to reduce the ALM mismatch?

MS. CARA LOW: Yes.

MS. KATHLEEN MCCANDLESS: MPI also uses Addenda for its convexity strategy for its assets?

MS. CARA LOW: At the moment matching, yes.

MS. KATHLEEN MCCANDLESS: Has MPI considered having Addenda adjust its IFRS-17 yield curve approach or its duration or convexity matching strategy to reduce that disconnect that we saw at the outset today of $45 million?

MR. GLENN BUNSTON: We've been talking with them about the possibility of adjusting the -- the proxy for the MUSH bond portfolio and to try to align -- better align the -- the assets with the liabilities.

So yes, we are talking to them about steps we can take to improve the -- the discounting.

MS. KATHLEEN MCCANDLESS: And do you have a sense as to when any of that might be coming into play?

MR. GLENN BUNSTON: We've had preliminary discussions with them on that. So we need to continue that and we need to better understand the -- the MUSH bonds and how the interest rates are set on those. So that Addenda can determine the best proxy from an interest rate perspective for the MUSH bonds.

MS. KATHLEEN MCCANDLESS: Thank you. Those are all my questions.

PANEL CHAIRPERSON: Thank you. Mr. Klassen...?

MR. CHRIS KLASSEN: Good morning. Thank you, Madam Chair.

CROSS-EXAMINATION BY MR. CHRIS KLASSEN:

MR. CHRIS KLASSEN: Good morning, MPI witnesses. Ms. Low, nice to see you again. Mr. Bunston, I'm Chris Klassen for CAC (Manitoba). I might be a familiar face from the back row in years past, but I think this will be the first time I'm asking you questions.

And as with past panels, I'll address my questions to both of you generally, and feel free to answer as is best appropriate.

First, you'll agree with me that MPI's investment returns are an important revenue source for the Corporation. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And leaving aside minor service and transaction fees, investment income is one (1) of only two (2) major revenue sources for the Corporation. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: The other being rates?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And if we assume stable claims costs and -- and other liabilities, this means that when the investment portfolio performs better than forecast, the Corporation is left, at the end of the year, with unanticipated retained earnings that contribute to reserves and reduce rate pressure on customers over time. Correct?

MS. CARA LOW: It would increase our RSR, but the rates are set independent of the RSR so it could eventually lead, through our proposed Capital Management Plan, to a rebate.

MR. CHRIS KLASSEN: Thank you. And when the investment portfolio underperforms, the Corporation is left with a revenue shortfall.

Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And such a shortfall would draw down MPI's existing reserves over time, putting upward pressure on rates to restore the reserves. Correct?

MS. CARA LOW: It really depends if you're talking about the investment portfolio for the Basic claims because that's what's used for pricing or if you're talking about the RSR investment portfolio.

MR. CHRIS KLASSEN: And I -- I appreciate the point, Ms. Low, and I recognize that I'm speaking generally. In doing so, being a little bit imprecise. So we'll move on and that's fine.

In an extreme case -- and using your suggested example of the RSR -- in a year where the RSR performs poorly, such a situation could lead to a mandatory capital build percentage added to customers' rates under the proposed Capital Management Plan?

MS. CARA LOW: Agreed. Agreed, yes.

MR. CHRIS KLASSEN: MPI's investment choices are guided by its investment policy statement. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And MPI has a new investment policy statement approved in March of this year. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And this new policy statement reflects changes to asset mixes made as a result of the recent asset liability management study. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And that's referred to here as an ALM study, correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And an ALM study at a high level is intended to optimize tradeoffs between wanting higher returns and lower risk. Correct?

MS. CARA LOW: That's what the study did, yes.

MR. CHRIS KLASSEN: And it achieves this by modelling liabilities in a liability benchmark portfolio. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And then, developing efficient portfolio options that take into account the liabilities. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And when we're talking about an efficient portfolio, "efficient" means that these portfolios achieve the maximum expected return for a given level of risk. Correct?

MS. CARA LOW: Right. It lies on the Efficient Frontier. Yeah.

MR. CHRIS KLASSEN: And so, in other words, an efficient portfolio minimizes risk for a targeted level of expected return.

MS. CARA LOW: Agreed. Yes.

MR. CHRIS KLASSEN: And we'll get into MPI's asset mix selections in more detail later.

But you'll agree with me for now that following the recent ALM study, MPI recommended to its investment committee to implement asset mixes proposed by Mercer. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And these were all efficient asset mixes. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: Again, meaning that they optimized expected return for a given level of risk. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: Which essentially means that MPI's asset mix selections came down to risk tolerance. Is that fair?

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

MR. CHRIS KLASSEN: Thanks, Mr. Bunston. You would agree that the composition of a liability benchmark portfolio was an important consideration in an ALM study. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And the reason for that is -- is that the liability benchmark portfolio defines the risk that needs -- that risks that need to be reflected in the asset mix. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And so, you'd agree then that any changes in the composition of the liability benchmark portfolio can affect the relative attractiveness of different asset classes in the policy portfolio in relation to the liability benchmark. Correct?

MS. CARA LOW: Can you repeat that, please?

MR. CHRIS KLASSEN: Any changes in the composition of the liabilities benchmark portfolio can affect the relative attractiveness of different asset classes to MPI. Correct?

MS. CARA LOW: Correct. Yes.

MR. CHRIS KLASSEN: Which can, in turn, affect the assets chosen by MPI. Correct?

MS. CARA LOW: Correct. Yes.

MR. CHRIS KLASSEN: And so, as an example, if the liability benchmark portfolio was designed with a short duration, then shorter term fixed income assets would look more attractive, all else equal, than -- than longer term assets. Correct?

MS. CARA LOW: Agreed. Yes.

MR. CHRIS KLASSEN: And the same would be true if the mixture of nominal and inflation linked bonds in the liability benchmark portfolio changed where nominal bonds don't offer inflation protection, but real return bonds do. Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: And the same would be true of credit risk if the benchmark -- the liability benchmark were to have a greater concentration of provincial versus federal bonds.

Correct?

MS. CARA LOW: Correct.

MR. CHRIS KLASSEN: Ms. Schubert, if you could bring to the screen the response to CAC/MPI-2-29, at page 2, please. And we'll pay attention to this table with the blue headings.

And before we get into the contents, I'll ask you to confirm that the table before us compares the composition of liability benchmark portfolios for both Basic claims and pension between the prior asset liability management study and the most recent study?

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

MR. CHRIS KLASSEN: And turning our attention now to the contents of the table, at the top, on the left, we see treasury bills.

And you'll confirm, sir, that treasury bills are used by the federal government?

MR. GLENN BUNSTON: Yes, they are.

MR. CHRIS KLASSEN: And I believe you noted yesterday, sir, that federally issued securities have virtually no credit risk, correct?

MR. GLENN BUNSTON: Yes. They're considered to be risk-free securities.

MR. CHRIS KLASSEN: And compared to provincial bonds, we understand that provincial bonds do carry credit risk, correct?

MR. GLENN BUNSTON: Yes, they do.

MR. CHRIS KLASSEN: And along with higher credit risk, you'll confirm, sir, that provincial bonds also have higher yields than federal bonds, all else equal?

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

MR. CHRIS KLASSEN: And so you'll agree, based on the table before us, looking with respect to the Basic claims portfolio, that compared to the prior ALM study, the allocation to treasury bills in the Basic liability benchmark portfolio was reduced by 23 percent, sir, from twenty-six (26) to three (3), correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: You'll agree also that most real return bonds are federal bonds, correct?

MR. GLENN BUNSTON: Yes. There are some provincially issued real return bonds, but most are issued by the federal government.

MR. CHRIS KLASSEN: And so when we look at the bottom of this table, you'll agree, sir, that the 8 percent decrease in real return bonds from sixty-six (66) to fifty-eight (58) implies a further shift away from federal bonds, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And so then we see both of those, 23 percent and 8 percent decreases, combined in the 31 percent increase in provincial bonds at the second line, correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And so roughly equating a 31 percent increase in provincial bonds to, you know, just shy of -- of a third of the portfolio, you'll agree that approximately a third of this liability benchmark portfolio transitioned from assets with virtually no credit risk to securities that do carry credit risk, being provincial bonds, correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And ignoring inflation sensitivity for a moment, you'll agree, sir, that -- that when designing the policy portfolio in relation to this Basic claims liability benchmark portfolio, these changes would make provincial bonds more attractive than federal bonds, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: Thank you, sir. And -- and if we turn our attention briefly to the right-hand part of the table addressing the pension or employee future benefits portfolio, you'll agree that we see a 35 percent reduction in real return bonds from 81 percent to 46 percent, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And you'll agree, sir, that this presents the pension liabilities as being less inflation sensitive in the current AL study as compared to the prior AL study, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And you'll agree, sir, that when designing a policy portfolio, having your liabilities presented as less inflation sensitive reduces the need for an inflation hedge in your investment, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: Referring back to the new investment policy statement, the panel will confirm that, for the first time, MPI has approved an investment policy statement calling for the inclusion of inflation-linked bonds in the Basic claims portfolio, correct?

MR. GLENN BUNSTON: Well, MPI has had real return bonds in its investment portfolio in the distant past, but not since the creation of the Basic claims portfolio in 2019.

MR. CHRIS KLASSEN: Understood, and I thank you for that clarification.

And you'll confirm, sir, just to make sure we're all on the same page, that the purpose of including real return bonds in investment portfolio is as a hedge against both inflation and real interest rate risks in MPI's liabilities, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And by way of illustration, you'll confirm that, all else equal, inflation tends to drive up MPI's claims costs, correct?

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

MR. CHRIS KLASSEN: And that has the effect of increasing the present value of the liabilities, correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And this, sir, is due to inflation making the goods and services to be purchased by MPI in processing future claims more expensive than they are today, correct?

MR. GLENN BUNSTON: Yes. The purchase of goods and services, and also the -- the payment of income replacement to the claimants.

MR. CHRIS KLASSEN: Thank you for that addition. Yeah, I appreciate that.

Nominal bonds are not linked to inflation, correct?

MR. GLENN BUNSTON: They are not. They have an expectation of inflation built into their yield.

MR. CHRIS KLASSEN: And so when MPI purchases a nominal bond, the coupon at the time of purchase will be the same coupon payment for the life of that bond, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And so the market value of such a bond depends on the present value of the coupon using a nominal discount rate, correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And so if inflation increases above the market's expectations that are used to value that bond, MPI's purchasing power with that bond decreases, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And so, in general, this is why a bond falls in price when inflation exceeds the expectations used to price it, correct?

MR. GLENN BUNSTON: Yes. Nominal rates generally rise, which results in a lower present value of the coupon payments.

MR. CHRIS KLASSEN: And this, sir, is why nominal bonds do not mitigate inflation risk in an investment portfolio, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And conversely, comparing that to an inflation-linked bond in the same circumstances, the inflation-linked bond or the real return bond's purchasing power is preserved through rising inflation, all else equal, correct?

MR. GLENN BUNSTON: That is correct.

MR. CHRIS KLASSEN: And that's because the coupon depends on a principal for real return bonds that rise with inflation, correct?

MR. GLENN BUNSTON: Yes. Both the principal and interest payments are indexed to changes in -- in the Consumer Price Index.

MR. CHRIS KLASSEN: So you'll agree,

sir, that MPI's recent inclusion of real return bonds in the Basic claims portfolio should improve the Corporation's ability to weather future spikes in inflation like Manitoba has seen since 2021, correct?

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

MR. CHRIS KLASSEN: We've seen it once before, Ms. Schubert. If you could bring up on the screen from MPI Exhibit 50 the rate update, Figure INV-1 at page 18, please.

And I won't belabour these points, Mr. Bunston, because you -- you came close to this discussion with counsel for the Public Utilities Board earlier, but just for setting up a discussion that we'll have in a moment, I'll -- I'll set some context here.

You'll agree, sir, that this is a presentation of MPI's Basic investment income over time?

MR. GLENN BUNSTON: Yes, it is.

MR. CHRIS KLASSEN: Including actuals dating back to 2017/'18 and forecasts out to '28/'29, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And if we look at

lines 18 and 19, sir, we see figures related to MPI's realized and unrealized gains or losses in marketable bonds, correct?

MR. GLENN BUNSTON: That's right.

MR. CHRIS KLASSEN: And if we look to 2021/'22, again at lines 18 and 19, and doing some rough math in your head combining those two (2) figures, you'll agree that, in its marketable bond portfolio, MPI experienced an approximate $127 million loss in 2021/'22?

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

MR. CHRIS KLASSEN: And you'll agree, sir, that that's related to inflation circumstances that were facing the Corporation at that time, and this was discussed at length in last year's GRA, correct?

MR. GLENN BUNSTON: Yes. An increase in interest rates which was partly caused by increases in inflation during that period, yes.

MR. CHRIS KLASSEN: And turning our attention to the next year, sir, 2022/'23, still at lines 18 and 19, you'll agree that similar circumstances conspired against the Corporation again and in that year led to $115 million loss in the bond portfolio?

MR. GLENN BUNSTON: Sorry, in which year?

MR. CHRIS KLASSEN: 2022/'23, and I'm looking at the 45.5 million in line 18 and the 70 million in line 19.

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

MR. CHRIS KLASSEN: And in response to those circumstances, Mr. Bunston, you'll confirm that MPI then elected to incorporate real return bonds into the Basic claims portfolio to mit -- to mitigate future losses due to above forecast inflation, correct?

MR. GLENN BUNSTON: Yes. That was decided and approved by our investment committee in February of 2023.

MR. CHRIS KLASSEN: And you'll agree, sir, that the -- the methodolo -- methodological change or the -- the change in approach that precipitated that decision was the reference to a real rather than nomin -- nominal liability benchmark, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: You'll confirm, sir, that MPI has not fully implemented its new investment policy statement asset mix, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: So MPI is not yet fully invested in real return bonds, correct?

MR. GLENN BUNSTON: Correct. We've only purchased $84 million of real return bonds to date.

MR. CHRIS KLASSEN: And we heard yesterday that MPI intends to invest an approximately 710 million through the bond overlay strategy, correct?

MR. GLENN BUNSTON: Well, that -- the actual amount is subject to the determination and approval of the hedge ratio which has not been approved yet.

MR. CHRIS KLASSEN: Understood, and I thank you for that clarification.

MR. GLENN BUNSTON: But our forecast was based on 710 million.

MR. CHRIS KLASSEN: Okay. Great. And the point, just before we move on, is -- is to confirm that MPI has purchased some RRBs, but based on the asset mixes approved in its recent investment policy statement, will be purchasing more, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: Ms. Schubert, if we could then switch from -- oh, no, I think we're already on the right document, from the rate update, correct.

Mr. Bunston, you'll recall a discussion with counsel for the Public Utilities Board, Ms. McCandless, earlier today that between the June application filing and the October rate update before us here, MPI made a downward adjustment of approximately $115 million in its projected income through its bond portfolio in 2023/'24, correct?

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

MR. CHRIS KLASSEN: And you also confirmed, sir, that this was primarily attributable to continued rising interest rates, correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And you'll agree, sir, that, in general, when interest rates go up bond prices go down?

MR. GLENN BUNSTON: Yes, they do.

MR. CHRIS KLASSEN: And you'll agree, sir, that inflation has a similar effect on bond prices such that when inflation goes up or is high, bond prices go down, correct?

MR. GLENN BUNSTON: Yes. Rising

inflation generally increases nominal yields, which would reduce bond prices.

MR. CHRIS KLASSEN: You'll confirm, sir, that inflation remains above target and also above the low point that was hit in June, correct?

MR. GLENN BUNSTON: Yes, the inflation is above the -- the Bank of Canada's long-term target of 2 percent and is above the low of 2.1 percent that was -- for Manitoba inflation that was reached in June.

MR. CHRIS KLASSEN: Thank you. And you'll agree, sir, that even in high interest rate circumstances where inflation is above target, real return bonds will still out perform nominal bonds, all else equal, correct?

MR. GLENN BUNSTON: Could you repeat that.

MR. CHRIS KLASSEN: Where inflation is above target, real return bonds will outperform nominal bonds, all else equal?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And that holds true even in a high interest rate environment, correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And you'll confirm, sir, and I can bring you to a reference if needed, that real return bonds have outperformed federal bonds in every period over the last ten (10) years, correct?

MR. GLENN BUNSTON: I believe that's correct.

MR. CHRIS KLASSEN: If you need a reference, we can go there.

MR. GLENN BUNSTON: No. I -- I recall the submission, yes.

MR. CHRIS KLASSEN: Okay. Thank you. Would you accept, sir, that if MPI was today fully invested in RRBs based on the ratio -- sorry -- the asset mixes approved in its investment policy statement, that that $115 million loss or projected loss in the 2023/'24 bond portfolio would be a smaller number?

(BRIEF PAUSE)

MR. GLENN BUNSTON: Could you repeat the question.

MR. CHRIS KLASSEN: Sure. And I'll back up briefly. Sir, you confirmed that both high interest rates and high inflation drive down bond prices, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And you confirmed that in both of those circumstances, real return bonds will out perform nominal bonds?

MR. GLENN BUNSTON: Yeah, real return bonds will perform well when actual realized inflation is higher than the breakeven inflation rate.

MR. CHRIS KLASSEN: And that holds true even in high interest circumstances, correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And you confirmed that that has held true for real return bonds in every period over the last ten (10) years, correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And so then my question to you, sir, was whether the now projected $115 million loss in the 2023/'24 year, based on the October rate update, would have been partly mitigated had MPI today been fully invested in RRBs?

MR. GLENN BUNSTON: If we had invested in them on a cash basis, yes, I believe that would be true. Of course, the recommendation is not to purchase them on a cash basis; it's to purchase them through the bond overlay strategy, which is -- involves borrowing through repurchase agreements, but, yes, I would agree with you.

MR. CHRIS KLASSEN: Thank you, sir. We'll move on from real return bonds.

And you'll confirm, sir, that -- and the reason for that is real return bonds was not the only change to MPI's asset mix approved by the Investment Committee following the recent ALM study, correct?

MR. GLENN BUNSTON: Yes, that's right. There were other changes.

MR. CHRIS KLASSEN: And for Basic claims, for example, these included the addition of commercial mortgages and real estate equity?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And for other investment portfolios you'll confirm, sir, that no new classes were added, but the asset mix was re-balanced, was I think your term, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: Ms. Schubert, if -- if you could, please, display from the 2023 GRA investment attachment 'H', slide 9.

And, Mr. Bunston, there's no magic to

this slide coming from last year's GRA or any particular place, but its purpose here today is an illustration of an Efficient Frontier.

And you'll confirm, sir, that that's what we have before us here, an -- an illustration of a general or hypothetical Efficient Frontier, correct, and this is from a Mercer presentation filed in last year's GRA?

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

MR. CHRIS KLASSEN: And if we were to put a point anywhere on this graph, sir, representing a hypothetical investment portfolio, this would tell us the amount of return that should be expected to exceed the value of the liabilities backed by the portfolio relative to surplus -- relative to surplus risk, correct?

MR. GLENN BUNSTON: Yes. So it's expected excess returns over and above the liability benchmark, yeah.

MR. CHRIS KLASSEN: Thank you. And the dark blue curved line that we see on the screen is referred to as an efficient -- excuse me -- Efficient Frontier, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And you'll confirm, sir, that the upper part of the curved line along the blue line -- sorry, I misspoke.

You'll confirm, sir, that a point along the blue line is considered to be an efficient portfolio, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: Meaning that it has maximized returns for a given level of risk, correct?

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

MR. CHRIS KLASSEN: And you see that the blue line also extends on the lower part of the graph angled down and to the right, sir, but you'd confirm that an investor would never be on the lower part of the curve because in such a circumstance, they could have less risk and more growth in surplus by moving up and to the left, correct?

MR. GLENN BUNSTON: Yes, there are more efficient points since you can have significantly more return for the same amount of risk by moving to the upper part of the curve.

MR. CHRIS KLASSEN: And if a hypothetical portfolio was in the light blue shaded area, sir, you'll confirm that that portfolio is not optimal or not efficient, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And that portfolio could have less risk or more surplus growth by moving left or up or some combination of both, correct?

MR. GLENN BUNSTON: True.

MR. CHRIS KLASSEN: Ms. Schubert, if you could take us briefly to Order 4 of '23 at page 121.

You'll confirm, Mr. Bunston, that this is the Order of the Public Utilities Board following last year's General Rate Application, correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And I'll draw your attention to the sentence beginning on the second line of the second paragraph here on this page, over toward the right, beginning with, "Mercer's analysis."

Do you see that, sir?

MR. GLENN BUNSTON: I do.

MR. CHRIS KLASSEN: And that sentence reads that:

"Mercer's analysis demonstrated that MPI has an opportunity to earn a greater return on its investments by

making adjustments to its asset mix
while maintaining its current level
of risk."

Correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: Ms. Schubert, could you take us now to COM Appendix 3 at page 13.

And this page will be familiar to you, Mr. Bunston, it's been -- as it's been on this screen already today.

You'll agree, sir, that the green dot at the bottom right of the screen represents what's called here the current portfolio?

MR. GLENN BUNSTON: Yes. That was the portfolio that existed prior to April 1st of this year.

MR. CHRIS KLASSEN: It was current at the time, correct, prior to recent changes being made?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And taking our learning from the last illustration that was on the screen, you'll confirm, sir, that the fact that the then current portfolio is below the Efficient Frontier confirms that it was not an efficient portfolio given the capital market assumptions used in the study,

correct?

MR. GLENN BUNSTON: It was not efficient relative to the portfolios that were created once the new asset classes were added to the mix.

MR. CHRIS KLASSEN: And so, based on the findings of the study, in recognizing the opportunities identified through the study, the formerly current portfolio was recognized as not maximizing returns for its level of risk. Correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And so in order to be made efficient or in order to bring the current portfolio onto the Efficient Frontier, its asset mix could have been adjusted to reduce risk and keep the same level of return. Correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And that's represented here by the dot 'C'. Correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: Or, alternatively, it could be adjusted to preserve risk and increase return, which is represented by 'B'. Correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And you confirmed to counsel for the Board earlier, that MPI selected the mid-point at point 'D'. Correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: MPI did not choose portfolio 'B'. Correct?

MR. GLENN BUNSTON: We did not.

MR. CHRIS KLASSEN: And, you'll confirm, sir, that portfolio 'D' is designed to make lower excess returns than portfolio 'B'. Correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And, you'll agree, sir, that as a result, the risk carried in the Basic claims portfolio, has been reduced as a result of the 2022 ALM study and the changes made by the Investment Committee. Correct?

MR. GLENN BUNSTON: Yes. There's less risk in terms of standard deviation -- or excess return volatility.

MR. CHRIS KLASSEN: Thank you. Ms. Schubert, could you take us to CAC/MPI-2-31. And we'll go to the response to 'E'. And, perhaps, first the request to -- the request 'E'.

And you'll confirm, sir, that in 'E', CAC (Manitoba) was asking for the surplus volatility for the 2017 GRA asset mix and the 2024 GRA asset mix.

Correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And, so if we scroll down to the response. Thank you, Ms. Schubert. And scrolling down to the table referencing Basic claims and, again, toward the bottom of the table where we see surplus volatility.

You'll confirm, sir, that this table illustrates a change from 4.02 percent surplus volatility to two point four eight (2.48) over the represented time period. Correct?

MR. GLENN BUNSTON: I see that. Yes.

MR. CHRIS KLASSEN: And, sir, this suggests that after both the 2017 Asset Liability Management study and after the 2022 Asset Liability Management study, MPI, both times, elected to reduce risk, such that we see the accumulative reduction surplus volatility here on the screen. Correct?

MR. GLENN BUNSTON: Well, this shows the reduction in surplus volatility between the 2017 asset mix and the current asset mix.

MR. CHRIS KLASSEN: Current asset mix.

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: Certainly. Thank you. Would you agree, sir, that MPI's investment risk tolerance has not changed materially in the past year?

MR. GLENN BUNSTON: Yes, I would agree with that.

MR. CHRIS KLASSEN: And, you'll confirm, sir, and we can go to references if needed, that inflation risk is no longer listed as among MPI's top corporate risks in the current filing. Correct?

MS. CARA LOW: That is correct.

MR. CHRIS KLASSEN: And, you'll confirm, Ms. Low, that in last year's GRA, inflation risk was, in fact, listed as among MPI's top corporate risks?

MS. CARA LOW: It was.

MR. CHRIS KLASSEN: And, back to Mr. Bunston. You'll confirm, sir, that MPI's investment risk tolerance has also not changed materially since the implementation of the asset mix following the prior AL study. Correct?

MR. GLENN BUNSTON: Yes, I'd agree with that.

MR. CHRIS KLASSEN: You'll confirm, sir, that MPI's Basic claims portfolio does not include equities. Correct?

MR. GLENN BUNSTON: It does not include equities. No.

MR. CHRIS KLASSEN: And, sir, this was

a constraint imposed on Mercer's development of the particular Efficient Frontier that MPI based its selected asset mix on. Correct?

MR. GLENN BUNSTON: Well, I believe that one of their Efficient Frontiers did include equities, so it was considered and evaluated.

MR. CHRIS KLASSEN: Correct. And MPI selected an efficient portfolio from the Efficient Frontier that did not include equities. Correct?

MR. GLENN BUNSTON: That's correct.

MR. CHRIS KLASSEN: Ms. Schubert, if we could go back to slide 9 from INV attachment 'H' from last year again.

And, again, you'll confirm, Mr. Bunston, that the blue line, the dark blue line on the screen, represents possible asset mixes that efficiently optimize return at a given level of risk matched to liabilities. Correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And, if we look along the blue line, we see at the left most point, a point labeled "matched bonds." Correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And, hypothetically, or -- that represents a -- a hypothetical low risk portfolio consisting of matched bonds. Correct?

MR. GLENN BUNSTON: Yes, I believe what that refers to is bonds that match the underlying and associated liabilities from a duration and dollar perspective.

MR. CHRIS KLASSEN: Right. Thank you. And if we look up toward the right, we see a point on the -- on the chart labeled "equities." Correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And that represents a hypothetical portfolio consisting of equities. Correct?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And you'll agree with me, sir, that the points on the line between matched bonds and equities are suggested to us to include some combination of both asset mix. Correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: With points close to equities being mostly equities and conversely points close to matched bonds, being mostly bonds?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: You'll agree, sir, that the concept of an information ratio is an indicator of a portfolio's relationship between risk and return?

MR. GLENN BUNSTON: Yes.

MR. CHRIS KLASSEN: And an information ratio could be represented on a graph like this with a line drawn from the origin of the graph through the point representing the portfolio. Correct?

MR. GLENN BUNSTON: Yes, it's the slope of the risk and return.

MR. CHRIS KLASSEN: Exactly. Thank you. And so, if we -- if we, you know, insert a line on this graph representing the information ratio of the matched bond portfolio, you'll agree, sir, that it won't be a vertical line. It might be toward one o'clock if we were to illustrate it on a clock, but it's -- for argument sake or for discussion sake today, near vertical. Correct?

MR. GLENN BUNSTON: Yes, I think what you're referring to is the instantaneous slope of the line, so take two (2) points, very close together and calculate the -- the -- the slope of those two (2) points.

MR. CHRIS KLASSEN: Yeah. And, sir, you'll agree with me that the slope of that line would not change materially if it were drawn, not between

the origin and the matched bond portfolio, but if it were drawn between the origin and a -- a portfolio on the line, slightly toward equities consisting of mostly matched bonds and a small amount of equities.
Correct?

MR. GLENN BUNSTON: There'd be a -- a marginal change in the slope. Yes.

MR. CHRIS KLASSEN: Marginal change in the slope. And, so that tells us, sir, that in the hypothetical matched bond portfolio, a small amount of equities could be included without materially affecting that portfolio's risk. Correct?

MR. GLENN BUNSTON: That's what this hypothetical graph is -- is indicating. Yes.

MR. CHRIS KLASSEN: Thank you. You'll confirm, sir, that the capital charges associated with investment and equities factored into MPI's decision to not include equities in the Basic Claims portfolio.
Correct?

MR. GLENN BUNSTON: Correct.

MR. CHRIS KLASSEN: And in MPI's submissions to the Investment Committee that we've reviewed today, MPI sited the capital charges for equities being in the range of thirty (30) to 40 percent. Correct?

MS. CARA LOW: It's a 30 percent charge for equities in the MCT.

MR. CHRIS KLASSEN: Thank you, Ms. Low. Madam Chair, those are my questions for CAC this morning. Thank you to MPI's witnesses.

PANEL CHAIRPERSON: Thank you, Mr. Klassen. Ms. Meek...?

MS. CHARLOTTE MEEK: Thank you, Madam Chair. Good morning to the Panel.

CROSS-EXAMINATION BY MS. CHARLOTTE MEEK:

MS. CHARLOTTE MEEK: Good morning, Ms. Low, good morning Mr. Bunston. I'm Charlotte Meek. We've met before, but I'm representing or assisting CMMG, or Coalition of Manitoba Motorcycle Groups.

I want to start with a -- just a couple of questions about MPI's historical perspective with -- in reference to certain asset classes.

You would agree with me that historically, RRBs or real return bonds, have not been included in MPI's investment portfolios since the creation of the Basic portfolio because, from MPI's perspective, RRBs were too expensive, were deemed to have significantly high volatility, and were not a good inflation hedge.

Would you agree with that?

MR. GLENN BUNSTON: I would agree that they've not been included in the portfolio. They were not included -- that's not because they're not a good inflation hedge. It's because we had thought the risk of inflation was low and there are other asset classes that provide inflation protection, like real estate and infrastructure, that have higher returns.

MS. CHARLOTTE MEEK: Okay. And that decision by MPI to, I think, at that time, remove real return bonds from the portfolio, was made contrary to expert evidence -- excuse me -- that was provided by CAC experts and contrary to Mercer's recommendations, which showed the benefits of including RRBs.

Would you agree with that?

MR. GLENN BUNSTON: Which recommendation are you referring to?

MS. CHARLOTTE MEEK: Sure. We can go to a -- a reference. If we could go to -- this is from the 2017 GRA, CAC/MPI-1-69, Attachment 'C'. We're going to go to page 10, please. And I think, if we scroll down to the bottom of this page.

So, we see here that this is indicating that the Mercer Report included a recommendation of 20 percent real return bonds and, then, they're indicating there that MPI has now dropped real return bonds from their target portfolio and this is Mr. Hum and Mr. Simpson, who oversees the experts at that time, are indicating that that was an extremely unwise decision. Do you see that there?

MR. GLENN BUNSTON: I see that there. Yep.

MS. CHARLOTTE MEEK: Okay. And MPI proceeded to remove real return bonds, despite these recommendations from various other sources?

MR. GLENN BUNSTON: My recollection is that we had our real return bonds in our portfolio many years ago, 15 plus years ago and, on the advice of our asset-liability management study completed with AON, I believe --

MS. CHARLOTTE MEEK: Yes. I think it's fair --

MR. GLENN BUNSTON: -- the decision was to replace them with real assets, which is real estate and infrastructure, which is what we did.

MS. CHARLOTTE MEEK: Sure. And, so -- so, acknowledging that MPI made a different decision from what was suggested by the Mercer Report here and by the experts from CAC?

MR. GLENN BUNSTON: Well, my

recommendation -- or my -- my recollection from the Mercer Report and the last ALM Study, was that real return bonds were not recommended and that's because a nominal liability benchmark was used for the study.

MS. CHARLOTTE MEEK: Thank you. But in this report here, you can see that Mercer was including a recommendation of 20 percent RRBs at that time.

MR. GLENN BUNSTON: I see that that's what written here on the page, but I don't recall Mercer recommending the purchase of real return bonds.

MS. CHARLOTTE MEEK: Sure. So, at that time, MPI chose to remove real return bonds from the portfolio?

(BRIEF PAUSE)

MR. GLENN BUNSTON: Can you just clarify the -- the time-frame of this particular recommendation?

MS. CHARLOTTE MEEK: I believe this was -- oh, I apologize -- this was a -- a historic -- a little bit earlier than I wanted. So sorry.

This is from the 2017 GRA and this was indicating that, at previous points, there were different recommendations suggesting RRBs be included in the portfolio. My real point here, sir, was saying that MPI had removed RRBs from the portfolio when the Basic portfolio was created. Is that correct?

MR. GLENN BUNSTON: It's correct. There were no real return bonds in the portfolio at the time of the creation of the -- the Basic claims portfolio, in 2019.

MS. CHARLOTTE MEEK: Thank you. And now, today, recommendations are being made to the Investment Committee recommending that real return bonds be included in the portfolio?

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

MS. CHARLOTTE MEEK: Okay. And I understand the Investment Committee has acted on that recommendation that real return bonds are going to be added or we've started purchasing them and we're going to continue purchasing them?

MR. GLENN BUNSTON: They accepted the recommendation that was put forward to them in February. Yes.

MS. CHARLOTTE MEEK: Thank you. And the intention of adding those asset classes or real return bonds to the Basic portfolio is that they are a potential hedge against long-term inflation.

Is that agreed?

MR. GLENN BUNSTON: Yes. Their coupon and interest payments are directly indexed to inflation. So, they are a -- a direct hedge against inflation.

MS. CHARLOTTE MEEK: Thank you. And can you confirm, is the recent inflationary experience a catalyst for MPI's change in policy regarding real return bonds?

(BRIEF PAUSE)

MR. GLENN BUNSTON: Could you repeat the question, please?

MS. CHARLOTTE MEEK: Sure. The question was: Is the recent inflationary experience a catalyst for MPI's change in policy regarding real return bonds?

MR. GLENN BUNSTON: It had an impact, but I would say that the primary driver was the -- the ALM study and the decision to use a real liability benchmark as the basis for that study which, then, led to the -- the recommendation to include real return bonds.

MS. CHARLOTTE MEEK: Thank you. I'd like to talk a -- a little bit about leverage now.

You would agree that financial leverage involves the use of debt or borrowed funds to get more exposure to an investment or project?

MR. GLENN BUNSTON: Yes.

MS. CHARLOTTE MEEK: And, in the bond overlay strategy that MPI is proposing, it will, effectively, use borrowed funds to buy real return bonds, as one step in a two-step process.

Is that correct?

MR. GLENN BUNSTON: That's correct.

MS. CHARLOTTE MEEK: And the second step of that proposal includes an off-setting transaction that negates most of the economic effects, which is the overlay strategy that includes reverse re-purchase agreement to sell nominal federal bonds to off-set the interest rate risk caused by real return bonds?

MR. GLENN BUNSTON: That is correct.

MS. CHARLOTTE MEEK: Thank you. And I think what a -- a -- the Addenda representatives were explaining yesterday is that the goal here is that there will be no substantial net leverage to the portfolio and, as a result, they have not defined it

as a leverage strategy. Is that correct?
MR. GLENN BUNSTON: That's correct.
MS. CHARLOTTE MEEK: Okay. And would you agree that, historically, MPI has been opposed to using leverage in the Basic portfolio?
MR. GLENN BUNSTON: We have not used leverage in the past. That's correct.
MS. CHARLOTTE MEEK: And can you provide some reasons as to why you have not used leverage in the past?
MR. GLENN BUNSTON: We have not used leverage in the past because it wasn't necessary and because the use of a leverage strategy that is not hedged can bring additional risk if the investment doesn't provide the return that is expected, but a strategy that uses long and short leverage, as the Mercer representatives indicated yesterday, significantly reduces that risk because of the fact that the strategy -- the net leverage is very close to zero.
MS. CHARLOTTE MEEK: Thank you. And yesterday, we had some discussions regarding the impact on the value of the accounting liabilities where equities would be added to the Basic portfolio.
Do you recall that -- that discussion

yesterday?

MR. GLENN BUNSTON: I do, yes.

MS. CHARLOTTE MEEK: And today, I want to focus on the liabilities, rather than any impact on the return on the portfolio or capital charges.

You would agree with me that where equities displace bonds in the portfolio, the discount rate would be impacted. Is that correct?

MR. GLENN BUNSTON: Discount rate would definitely be impacted, yes.

MS. CHARLOTTE MEEK: Okay. And if we could go to the investment's chapter from this year's General Rate Application, appendix 14, page 20, please.

And we looked at this a little bit yesterday. And again, these are the negative outcomes that MPI has identified would occur were the Corporation purchase real return bonds on a cash basis. Is that correct?

MR. GLENN BUNSTON: Correct.

MS. CHARLOTTE MEEK: And indicate -- sorry, pardon me -- MPI indicated that there would be a reduction in the yield of the fixed income portfolio where real return bonds were purchased on a cash basis. Correct?

MR. GLENN BUNSTON: Yes.

MS. CHARLOTTE MEEK: And there would be a similar negative outcome where equities were purchased on a cash basis, being that there would be a reduction in the yield of fixed income portfolio.

Agreed?

MR. GLENN BUNSTON: The allocation to the fixed income portfolio as an overall proportion of the portfolio would decline, yes.

MS. CHARLOTTE MEEK: Okay. And so, putting aside factors relating to portfolio return or capital charge effects, you'd agree that real return bonds are penalized or they look less attractive because of the accounting used in valuing the liabilities?

(BRIEF PAUSE)

MR. GLENN BUNSTON: Could you clarify the question? Or just maybe --

MS. CHARLOTTE MEEK: I can repeat it for you.

MR. GLENN BUNSTON: -- repeat it. That would be helpful to start.

MS. CHARLOTTE MEEK: So putting aside

factors relating to portfolio return or capital charge effects, you'd agree that real return bonds are penalized or they look less attractive because of the accounting used in valuing the liabilities.

MR. GLENN BUNSTON: Well, they have a -- a negative impact on the yield of the portfolio by virtue of the fact that there's less credit risk associated with federal bonds, which -- real return bonds are generally issued by the federal government, so they have lower yields than provincial bonds.

So they reduce the yield of the portfolio, which has a negative impact on the discount -- the liability discount curve.

MS. CHARLOTTE MEEK: Right. And similarly, that -- that same rationale would apply to equities in the same way that equities would look less attractive in that way because of the accounting used to value the liabilities.

MR. GLENN BUNSTON: Well, it depends on how equities would be reflected in the discount curve and what -- what rate would be associated with the equities in that discount curve.

MS. CHARLOTTE MEEK: And -- and we agreed earlier that equities would reduce the discount curve -- reduce the discount rate. Addition of equities to the -- to the portfolio would reduce the discount rate?

(BRIEF PAUSE)

MS. CARA LOW: Generally, equities would have a higher yield, so that would lower your liabilities. But they're very -- it's very volatile, right.

So hard to know exactly what yield to use when you're looking at something that's short term versus a long term average. So long term, I think, Addenda mentioned six-and-a-half (6 1/2), but often you would see a 6 percent if it's a long term historical average. Hard to know how to discount something in the next twelve (12) months with the equity yield.

MS. CHARLOTTE MEEK: Okay. Thank you. And you would agree that the -- the bond overlay strategy that is proposed adds some costs and complexities, but those are factors that MPI has determined are acceptable in order to buy real return bonds in order to hedge some inflation risk?

MR. GLENN BUNSTON: Yes.

MS. CHARLOTTE MEEK: Okay. And I'm

wondering if MPI can provide, by way of undertaking, a quantification of the impact on the discount rate of adding equities to the portfolio, similar to what MPI has provided for real return bonds?

MR. STEVE SCARFONE: So, Ms. Meek, just for that particular question, is there a recommendation on the allocation to equities?

MS. CHARLOTTE MEEK: I think it would be similar to the -- what we've done with real return bonds. So kind of replicating what we've done with real return bonds and then applying the same thing to equities.

But I could maybe double-check that. Maybe I could check offline with you and -- and confirm if there was a specific allocation we were thinking of.

(BRIEF PAUSE)

MS. CHARLOTTE MEEK: So just -- and we're just looking for the impact on the -- the liability discount rate.

MS. CARA LOW: So just in the pro formas, not for the new money yield for ratemaking?

MS. CHARLOTTE MEEK: Yes, I -- I think

so.

(BRIEF PAUSE)

MR. STEVE SCARFONE: Ms. Meek, we're just discussing whether it can be done at this late stage. But it seems to be something that could be done.

MS. CHARLOTTE MEEK: Thank you. So maybe subject to just the allocation portion of that, your -- your question about allocation, maybe I could clarify that with you offline once I -- I have a response from my consultant, and we can just confirm the undertaking then?

MR. STEVE SCARFONE: We'll first have to change the investment policy statement to allow for equities to be purchased, and then we'll do that.

MS. CHARLOTTE MEEK: Understood. Thank you. Those are my questions. Thank you, Madam Chair.

PANEL CHAIRPERSON: Thank you, Ms. Meek. Mr. Gabor...?

BOARD CHAIR GABOR: I think most of my questions will be going to Mr. Bunston.

Mr. Bunston, at a high level, I just

want to go through the decision-making process on the investments.

As I understand, you have a team of people that makes recommendations to the Investment Committee, is that correct?

MR. GLENN BUNSTON: So my team does research and we bring that research to the working group, who reviews and vets that research. And then, if they deem it to be satisfactory, then it goes to the Investment Committee.

BOARD CHAIR GABOR: Okay. And for certain decisions like asset mix, who makes the decision; is it the working group or the investment committee?

MR. GLENN BUNSTON: The investment committee has the authority to approve the asset mix or -- actually recommend it to the -- to the Board for approval.

BOARD CHAIR GABOR: Okay. That was the question I have is it -- the decision maker is the Board, the Investment Committee makes recommendations to the Board. Is that correct?

MR. GLENN BUNSTON: Correct. Yes.

BOARD CHAIR GABOR: So hedge ratio, same process?

MR. GLENN BUNSTON: Yes.

BOARD CHAIR GABOR: The overlay strategy, same process?

MR. GLENN BUNSTON: Yes, it was recommend to the Investment Committee in February, and they recommended it to the -- to the Board.

BOARD CHAIR GABOR: Okay. In terms of what investments are made then, am I correct that no investments are made until they go through the Investment Committee and then go to the Board for approval?

MR. GLENN BUNSTON: In terms of new asset classes, yes. So we did purchase real return bonds in December, which was prior to discussing with the Investment Committee.

But as I said, we -- the investment policy statement gives us the approval to purchase government bonds which real return bonds fall under that category.

BOARD CHAIR GABOR: Okay. But there wouldn't be an individual such as yourself or -- or someone else who would have the authority to make an investment without running it first through the Investment Committee and -- and then through the Board?

MR. GLENN BUNSTON: Assuming it was a new asset class that was not previously approved, yes.

BOARD CHAIR GABOR: Okay. You indicated earlier, I believe, right at the outset of the testimony of this panel, quote:

"Risk management is the highest priority. Returns are secondary."

Is that correct?

MS. CARA LOW: For the Basic claims portfolio, yeah.

BOARD CHAIR GABOR: For the Basic claims portfolio.

MS. CARA LOW: Yeah.

BOARD CHAIR GABOR: Okay. I just want to take you to -- Kristen, could you pull up the annual report, the last annual report. I believe it's MPI Exhibit 10. Could you go to page 48. Okay. No, at the -- go to the top, please. That's fine right there. Okay.

And you have -- this impairment category, it's in general categories, bonds, private debt, other investments. Is that correct?

MS. CARA LOW: Correct.

BOARD CHAIR GABOR: Okay. Kristen, could you pull up PUB/MPI Exhibit 1-38. Okay. And go to that figure.

I assume that this figure is a breakdown from the figure that was in -- the table that was in the annual report?

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

BOARD CHAIR GABOR: Okay. So what we have here is we have Addenda number 1 is a bond, number 2 is fixed income. Is that correct?

MR. GLENN BUNSTON: Number 2 is -- is private debt, which is a form of fixed income, yes.

BOARD CHAIR GABOR: Okay. Number 3 is fixed income?

MR. GLENN BUNSTON: Again, private debt type of fixed income.

BOARD CHAIR GABOR: Number 4, Province of Ontario?

MR. GLENN BUNSTON: It's a bond, yeah.

BOARD CHAIR GABOR: Bond. Number 5, fixed income?

MR. GLENN BUNSTON: Private debt --

BOARD CHAIR GABOR: Private debt. Number 6?

MR. GLENN BUNSTON: Six (6) is a venture capital investment.

BOARD CHAIR GABOR: Okay. So -- and as I understand it, CentreStone Ventures Limited is a life science venture capital fund that invested in early stage companies in the life sciences and health care sector. Is that correct?

MR. GLENN BUNSTON: Yes.

BOARD CHAIR GABOR: That's a high-risk sector, isn't it?

MR. GLENN BUNSTON: Venture capital generally is high risk, yes.

BOARD CHAIR GABOR: Yeah. Early stage venture capital.

MR. GLENN BUNSTON: Yeah.

BOARD CHAIR GABOR: This isn't second stage or -- this is early stage.

MR. GLENN BUNSTON: M-hm.

BOARD CHAIR GABOR: How does that fit with a policy that says:

"Risk management is the highest priority. Returns are secondary."

This is the highest risk.

MR. GLENN BUNSTON: So CentreStone is not in the Basic claims portfolio. It's in one of the non-Basic portfolios.

BOARD CHAIR GABOR: But I -- I do not

-- I don't understand why MPI is investing in a high-risk venture capital fund.

MR. GLENN BUNSTON: Yeah. So this is a legacy investment that was made prior to my time at MPI, probably twenty (20) years ago, and it's the last remaining venture -- or venture capital investment that we have in our portfolio. And as you can see, it's -- the dollar value of the investment is less than a million dollars.

BOARD CHAIR GABOR: I appreciate it's less than a million dollars. I'm just -- do you know when the investment was made?

MR. GLENN BUNSTON: Not specifically. I know it was prior to my time at MPI.

BOARD CHAIR GABOR: Do you know what sort of decision making would it have gone through?

MR. GLENN BUNSTON: I don't.

BOARD CHAIR GABOR: Okay. Do you know whether the company is active or inactive?

MR. GLENN BUNSTON: It's a -- it's a pooled fund, and if I recall they have I believe one (1) investment remaining that they are working on liquidating.

BOARD CHAIR GABOR: And how do you determine the market value for that -- I mean, I don't know. Is it the market value of the pooled fund or the market value of the asset?

MR. GLENN BUNSTON: It's the market value of our interest in the -- in the pooled fund. The Province of Manitoba monitors that for us, and I believe it's based on reporting from the fund manager. And I believe the -- the final investment in the fund is -- is an equity interest in a -- in a company which I believe is listed.

BOARD CHAIR GABOR: Okay. Do you know if the decision to invest in this was made by the board of MPI, or was it directed by government or somebody else?

MR. GLENN BUNSTON: No. I wasn't involved in the decision making so I couldn't -- couldn't speak to that.

BOARD CHAIR GABOR: Okay. Mr. Scarfone, I'm going to ask for an undertaking. I realize it's a long time ago.

I -- I'd like to know how this investment was made and whether it went through -- if -- if their records would indicate it's gone through the normal investment process or if it was directed by somebody from outside the Company.

MR. STEVE SCARFONE: We can make those

inquiries, Mr. Gabor. Just for context, Mr. Bunston said it was -- the purchase was made prior to his time at MPI.

BOARD CHAIR GABOR: Yeah.

MR. STEVE SCARFONE: Didn't say how long he'd been at MPI.

MR. GLENN BUNSTON: Yeah. So I joined MPI in 2003, so I believe it was made prior to that time.

BOARD CHAIR GABOR: Okay. My -- my understanding is this fund was created in 2004.

MR. STEVE SCARFONE: Okay. So we'll make those inquiries, Mr. Gabor.

BOARD CHAIR GABOR: Okay. So, yeah, if you could make those -- if you could it, I -- yeah. And -- and if the records would indicate what the process was to decide to -- to make that investment.

MR. STEVE SCARFONE: Yes, whether it was approved by the board of directors?

BOARD CHAIR GABOR: Correct. Thank you. Those are my questions.

--- UNDERTAKING NO. 33: MPI to advise how investment in CentreStone Ventures Limited was made and whether their records indicate whether it went through normal investment process or if it was directed by somebody from outside the Company

PANEL CHAIRPERSON: Thank you. Ms. Boulter...?

BOARD MEMBER BOULTER: I have one (1) question. On the real return bonds, 84 million has been purchased so far of a goal of seven hundred and ten (710). So maybe it's two (2) questions.

First, when do you think you're going to have that all done? And is the fact that you haven't got it done yet a reflection of other issues?

MR. GLENN BUNSTON: Well, a number of things need to happen before we can start to implement the program. First we have to have the -- the manager selected, so we're in the process of that search.

Once the manager is selected, we need to have a contract signed and in place, and then we can start investing the funds. And the manager will need to source real return bonds, and the market is -- is quite illiquid, particularly given the government's announcement they -- they would no longer issue new real return bonds approximately a year ago.

So I think the estimate was that it could take as much as six (6) months to -- to source $6- to $700 million of real return bonds.

We also will consider purchasing treasury inflation-protected securities, or TIPS, in the US, and so they are much more liquid. So I think we'll start looking for real return bonds, and if we struggle, we may turn to the US market to expedite the process.

BOARD MEMBER BOULTER: Yeah. That was my second question is if you would be looking to the US. So thank you very much. That's all.

PANEL CHAIRPERSON: Ms. Nemec...?

BOARD MEMBER NEMEC: My question is on -- or one (1) question, but it's multiple parts and it is about real return bonds.

You mentioned that governments in Canada are no longer offering real return bonds. They're getting away from offering real return bonds.

Do you know what the -- what -- what risks or business issues they're dealing with that they have chosen not to issue real return bonds?

MR. GLENN BUNSTON: Well, in the press

release at the time, the federal government indicated that the market was illiquid and they weren't -- there wasn't significant trading volume in the market. And so that was one (1) of the reasons they gave for -- for no longer issuing the bonds.

I can tell you that the decision caught market participants, both investors and investment dealers, off guard and by surprise. Investors who have inflation-linked liabilities do depend on the market to hedge those -- that inflation indexation, and they're -- they're generally bought and hold -- and held to maturity.

So there is -- there was -- there was high demand for them, but there wasn't a lot of trading in them; that's because investors would buy them and keep them.

I think probably the -- the real reason it seems was that it was a high-cost funding source for the federal government, and so they decided to exit the market for that reason.

But it does make Canada unique in that we're the only G7 nation that doesn't have an active inflation-linked bond market, and so there -- there has been significant lobbying on behalf of investors and investment dealers to encourage the federal government to reconsider their decision.

BOARD MEMBER NEMEC: Have you noticed, or can you comment on the US, if there was any decrease in the provision or -- of real return bonds in the US or elsewhere?

MR. GLENN BUNSTON: I don't believe --

BOARD MEMBER NEMEC: Just wondering if there's any trend, if Canada's at start and -- and other people are following.

MR. GLENN BUNSTON: No, I don't believe there's been any change in the -- in the US or any other G7 nation in terms of their issuance of real return bonds as a result of the decision here in Canada.

BOARD MEMBER NEMEC: Okay. Do you know if ICBC or SGI have had real return bonds in their portfolios, Basic portfolios? Is there any comparison been done to -- to them?

(BRIEF PAUSE)

MR. GLENN BUNSTON: No, I don't know if they have real return bonds in their investment portfolios.

BOARD MEMBER NEMEC: Okay. As of

December 2022, there -- real returns bonds of about $82 million, I think, were purchased.

Can you estimate what saving you might have had with interest rates continuing to increase from having that 82 million from a revenue perspective?

And there -- I know that's going to be a napkin kind of calculation.

MR. GLENN BUNSTON: I think -- well, I can tell you that the reason we bought them in December was because we were aware -- we were made aware that there was a seller of real return bonds. And given the liquidity in the market, we believed that there was an opportunity to -- to source the real return bonds and to -- and to obtain them, so we decided to -- to do that.

I think the benefit of owning those bonds would come in -- in terms of to the extent that inflation had exceeded the breakeven inflation rate during that period, which it has. So I think that there has a benefit to the portfolio, but it was more about obtaining some real return bonds, which are generally hard to find in the market.

BOARD MEMBER NEMEC: Okay. And I guess my -- the question is, if you had certainty that inflation went back to 2 percent, interest rates were starting to decline, would this be a strategy that you would employ?

MR. GLENN BUNSTON: It would. As Mr. Robert indicated yesterday, by definition, this strategy is meant to protect MPI from unexpected inflation and -- which can't be predicted.

So even in a -- which you might call a benign inflationary environment, there still is the risk that inflation exceeds expectations, and that's what this strategy is -- is meant to protect from.

BOARD MEMBER NEMEC: Okay. Thank you.

PANEL CHAIRPERSON: Mr. Bass...?

BOARD MEMBER BASS: Mr. Bunston, you're familiar with the Ellement reports, correct?

MR. GLENN BUNSTON: Yes.

BOARD MEMBER BASS: Probably more than you would like I would expect. They're -- they're quite informative. So I wanted to ask you some questions about them. Kristen, could you pull up page 3,967 of the GRA.

So in the middle paragraph, the sentence that talks about:

"This universe is comprised of pooled funds weighted to MPI's policy asset mix which provides a performance comparison that is independent of asset mix."

You see that?

MR. GLENN BUNSTON: Yes.

BOARD MEMBER BASS: Okay. So Ellement has done part of the work in terms of comparing different asset managers to take into account the investor's change in asset mix in investment policy statements, correct?

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

BOARD MEMBER BASS: Okay. And this statement appears -- I'm going to -- to refer to the Basic claims report, the Rate Stabilization Reserve report and the employee future benefits report.

And the statement is the approach that Ellement issues with respect to all of the, right?

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

BOARD MEMBER BASS: Kristen, could you turn to page 3,966, please.

So this is the Basic claims report, the Canadian fixed income comparison. And when I look at this, my questions are -- are primarily with respect to performance, as you might expect from the -- the reference in -- in these reports.

But when I look at the total fixed with IMP (phonetic) for four (4) years, that's -- MPI is at the 89th percentile, right?

MR. GLENN BUNSTON: Yes.

BOARD MEMBER BASS: And with respect to these rankings -- well, if you write a test and you get a hundred, that's really good, right.

But in these rankings, it's the other way around; the higher the number, the worse your performance, right?

MR. GLENN BUNSTON: That's right.

BOARD MEMBER BASS: Yeah. So 89 isn't so hot, agreed?

MR. GLENN BUNSTON: Yes. Eighty-nine means that only 11 percent of the funds in the universe had a worse performance.

BOARD MEMBER BASS: Yeah. Okay. So if we turn now to page 2,977, Kristen. So this'll be the Rate Stabilization Reserve total fund, four (4) year performance, 100. So everybody else was better than the MPI investment managers. And, Kristen, if you could change to page 3,993.

So this is the employee future benefits total fund, four (4) year. Fifty-three is the percentile, so a little better than the other ones but still not so hot. Would you agree?

MR. GLENN BUNSTON: It's approximately average, yes.

BOARD MEMBER BASS: Yeah. Okay. And page 3,994, Kristen.

So this is total fixed income. Sorry, the last one was total funds. This one is total fixed income, but it's at -- four (4) year is at the hundredth percentile?

MR. GLENN BUNSTON: It is, yes.

BOARD MEMBER BASS: So these reports would be reviewed by the Investment Committee working group that both you and Ms. Low are members of, correct?

MR. GLENN BUNSTON: Yes. We use the Ellement reports in our reporting to the -- to the Investment Committee which the working group has access to.

BOARD MEMBER BASS: Sorry, these reports go to the Investment Committee of the Board, as well?

MR. GLENN BUNSTON: Yes.

BOARD MEMBER BASS: Okay. And has the Investment Committee working group considered any changes to the investment managers over the last four

(4) years?

MR. GLENN BUNSTON: Well, we've evaluated -- well, we constantly evaluate the performance of our external managers. We've had some equity managers who have been on our -- what we call our watch list because their performance has been subpar over a rolling four (4) year period.

Those two (2) managers have been removed from the watch list because their performance has improved.

But in terms of this specifically here, fixed income, I think one (1) thing to keep in mind is that some of these performance differences are likely caused by differences in duration between our portfolio and the portfolio -- the -- the benchmark portfolio, so duration has some impact on -- on performance here, as well.

BOARD MEMBER BASS: But doesn't that initial statement that we looked at saying that it's been adjusted for that?

MR. GLENN BUNSTON: It was adjusted for asset mix, so, in other words, the mix between stocks and bonds and alternatives, but not necessary adjusted for duration within the fixed income investments.

BOARD MEMBER BASS: So let's maybe put it another way. From MPI's point of view, is it quite satisfied with the performance of all of its investment managers in these three (3) portfolios?

MR. GLENN BUNSTON: Yes, I would say that we're satisfied with the performance of our managers.

Again, on the Basic claims portfolio it -- our primary objective is to match the duration of our assets and liabilities so that the asset portfolio has a similar interest rate sensitivity to the liabilities. That is the primary objective.

And performance relatively to our peers is a secondary objective.

BOARD MEMBER BASS: So, that opinion, would be the opinion of the Investment Committee working group?

(BRIEF PAUSE)

MR. GLENN BUNSTON: So, this report doesn't generally go to the working group or to the Investment Committee. We use extracts from this report.

In -- in other reports that go to the

Investment Committee and to the working group. So, for example, in the annual review of each asset class, we'll use the -- the percentile rankings to provide context of the manager's performance relative to their peers.

And the performance that goes to the Investment Committee on a quarterly basis is drawn from this -- this report.

And, so the Investment Committee sees the performance of each manager relative to their peers. And my team brings forward recommendations on when managers should be added to the watch list.

We have a policy that outlines when managers should be added to that watch list, which has both quantitative and qualitative criteria. Quantitative criteria sets out under performance, relative to benchmarks.

So, yes, I'd say that we were satisfied. And when I say "we," I say the -- the working group and the Investment Committee with the performance of our external investment managers.

BOARD MEMBER BASS: Okay. Thank you.

PANEL CHAIRPERSON: Mr. Scarfone...?

MR. STEVE SCARFONE: Thank you, Madam Chair. I'm aware of the time so I'm just going to be quick with a few questions on re-direct.

RE-DIRECT EXAMINATION BY MR. STEVE SCARFONE:

MR. STEVE SCARFONE: Ms. Schubert, both Ms. McCandless and Mr. Klassen made reference to appendix 3. It was -- I think at page 13 of that appendix that showed -- yeah, that one. Thank you.

So, let me first ask you, Mr. Bunston, did MPI see depart from any of the recommendations of Mercer under the ALM?

MR. GLENN BUNSTON: No, we do not.

MR. STEVE SCARFONE: Okay. So, if you and Ms. Low and other smart people at MPI disagree with Mercer, who wins that particular dispute?

MS. CARA LOW: We collaborate. So, if there's something that we're not fully aligned with, we would go through the pros and cons. We would talk -- bring in our CFO and our Controller and perhaps even our Director of Evaluation.

We have a lot of ad hoc conversation and then we take it to our IC working group. And, of course, our investment analysts, as well.

So, I don't think anyone ever wins. There's a lot of discussion ongoing all the time.

MR. STEVE SCARFONE: Okay. Thank you

for that. And, on this particular graphic that's before us, everyone confirmed that down at the bottom right is where MPI was currently at. Correct?

MR. GLENN BUNSTON: Correct.

MR. STEVE SCARFONE: And they've selected 'D' on that red dotted line?

MR. GLENN BUNSTON: Yes, the -- portfolio 'D' was recommended and approved.

MR. STEVE SCARFONE: That's the recommendation by Mercer?

MR. GLENN BUNSTON: Yes, Mercer recommended 'D' as well.

MR. STEVE SCARFONE: And, so that's, as Mr. Klassen pointed out, that's the Efficient Frontier and so Mercer is saying MPI, you're way down there, you should be up here on this line. Correct?

MR. GLENN BUNSTON: Yes. Like I said, once the real return bonds, mortgages and real estate are added, the -- the new Efficient Frontier was created and the recommendation was to move to add those asset classes and move up to adopt portfolio 'D'.

MR. STEVE SCARFONE: Okay. Thank you. And the reason I ask is 'cause -- where you're currently at, on this particular graphic, Mercer --

and -- and you'll recall, Mr. Bunston, was here with Mr. McCarchuk (phonetic) at the time.

In 2017 they did Efficient Frontier modeling at the time?

MR. GLENN BUNSTON: They did.

MR. STEVE SCARFONE: And so that current was at or near that Efficient Frontier?

MR. GLENN BUNSTON: Yes, it was.

MR. STEVE SCARFONE: So, why did the goal post keep moving?

MR. GLENN BUNSTON: Well, like I said, it was because -- well, first of all, we decided to use a real liability benchmark in this asset liability management study and so that resulted in capturing the inflation risk associated with the liabilities and the -- the resulting recommendation was to add real return bonds to -- to hedge that risk. And real estate and mortgages were also recommended.

MR. STEVE SCARFONE: Okay. Thank you. And so this next question might reveal my ignorance, but that's okay.

Can you purchase real return bonds if the Corporation was to make use of a nominal liability benchmark?

MR. GLENN BUNSTON: We could. Yes.

MR. STEVE SCARFONE: Concerning the performance of nominal bonds versus real return bonds, is that largely the result in -- Mr. Klassen indicated I think, over the past ten (10) years.

Is that largely the result of the inflation pressures that we've seen in the past couple years or what's the -- what is the reason for the RRBs outperforming nominal bonds?

MR. GLENN BUNSTON: Well, I think the recent increase in inflation has played a part into that. And that may have caused them to outperform in the short term. And, maybe, influenced the long term averages as well, but I'd have to take a closer look at the -- the data to confirm that.

MR. STEVE SCARFONE: Okay. Thank you. And, Ms. Meek asked you and pointed you to some evidence that would show where MPI said if -- with the purchase of real return bonds on a cash basis, it would push aside some yield on the fixed income portfolio. The provincial bonds, specifically, would have to be sold.

Why is that not the case with the overlay strategy?

MR. GLENN BUNSTON: Well, the overlay strategy is -- is largely a financing strategy, which means we're -- would be borrowing to fund the purchase of the real return bonds and, conversely, lending to -- to finance the -- the short sale of nominal federal bonds.

MR. STEVE SCARFONE: Okay. And what's the process involved, Mr. Bunston, to have the Investment Policy Statement changed to allow for the purchase of equities in the Basic Claims portfolio.

How does that look if -- if the Corporation wanted to do that?

MR. GLENN BUNSTON: Well, I think we would want to have -- have an ALM study in place that recommended the purchase of those real equities and quantify the impact as -- to form the basis of any recommendation.

And then take a recommendation to the Investment Committee. So, we would need to do the analysis and -- and then formulate a recommendation and take it to the Investment Committee at one of their meetings.

MR. STEVE SCARFONE: Thank you. Does the fact that the short term loans under the overlay strategy are backed by collateral reduce the risk of that strategy?

MR. GLENN BUNSTON: Yes, the -- the

collateral means that if the counter-party is unable to make good on the -- the contract that we -- we own -- we physically hold treasury bills that we could liquidate to -- to make us whole if the counter-party is unable to -- to make the -- the payment that they would be required to make under the -- the bond overlay contract -- or the repurchase agreement.

MR. STEVE SCARFONE: Okay. Thank you. And then just to clarify a question that Mr. Klassen asked.

So the real return bonds are effective because they don't lose their value under the pressures of inflation. Is that fair?

MR. GLENN BUNSTON: Yes, your purchasing power is protected if you buy a real return bond so, the -- the real coupon rate is adjusted for inflation. So, increases in -- in inflation do not negatively impact the real -- the real yield of the bond.

MR. STEVE SCARFONE: And the last question for Ms. Low.

On this graphic here Ms. McCandless made you aware that by -- by moving up to that line, so we would achieve greater returns with less risk, so that sounds great, but there's a capital cost to that.

Correct?

MS. CARA LOW: Correct.

MR. STEVE SCARFONE: And what considerations does the Corporation make when moving toward a recommended frontier, like we see there.

Is there any consideration to how that impacts the capital required which, of course, would mean we'd hold more which, of course, would mean a rebate might occur later than it might otherwise.

Correct?

MS. CARA LOW: It was considered, that's one of many factors that was considered.

MR. STEVE SCARFONE: Thank you. Those are all my questions.

PANEL CHAIRPERSON: Thank you. Mr. Gabor has --

BOARD CHAIR GABOR: Yeah, yeah, sorry. I apologize for this. I was sort of chewing on Mr. Bass's questions.

Mr. Bunston, Mr. Bass asked you if you were satisfied with the performance of the managers and you said you were.

The question I have is: What would it take for you to be dissatisfied with them?

MR. GLENN BUNSTON: Well, like I said,

we look at their performance over rolling four (4) year periods relative to their benchmarks and so their performance relative to the -- to the benchmark set out in the Investment Policy Statement is the -- the primary evaluation.

But, we also look at the -- the interest rate hedging strategy and -- and ensure that the fixed income portfolio is -- is managing it and offsetting the interest rate risk associated with the liabilities.

BOARD CHAIR GABOR: Okay, so those are the specific performance metrics that you're looking at?

MR. GLENN BUNSTON: Yes.

BOARD CHAIR GABOR: Okay. And if they hit that -- if they fall below that metric, is there an automatic trigger that says we have to either review this or change them?

MR. GLENN BUNSTON: Then, they go onto our watch list and we monitor their performance and report back every six (6) months.

BOARD CHAIR GABOR: Okay. Same milestones?

MR. GLENN BUNSTON: Relative to the benchmark set out in the Investment Policy Statement.

Yep.

BOARD CHAIR GABOR: Thank you.

PANEL CHAIRPERSON: Thank you. Thank you very much everyone, that concludes the MPI Investment Panel. Thank you, Ms. Low and Mr. Bunston.

We'll be back tomorrow morning at nine o'clock and I believe we are commencing with the CAC witness from Oliver Wyman and, then, proceeding with cross-examination on Undertakings. Is that correct?

MS. KATHLEEN MCCANDLESS: That's correct.

PANEL CHAIRPERSON: Okay. Anything further?

MS. KATHLEEN MCCANDLESS: That's all.

PANEL CHAIRPERSON: Okay. Thanks very much. See you tomorrow.

--- Upon adjourning at 12:18 p.m.

Certified correct,

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Wendy Woodworth, Ms.