Setting Just and Reasonable Rates – the Regulatory Test – the Regulatory Context

Setting Just and Reasonable Rates (s. 26 *CCPRAA* and s. 77 *PUB Act*)	Prior GRA History	PUB Actions and Findings	New Developments relating to this proceeding	CAC Manitoba Preliminary Commentary	Selected CAC Manitoba Issues for hearing
1. Are the forecasts of revenue, and costs, reasonably reliable? (See PUB 5/12, page 27)					
	Claims incurred and forecast variance Between the 2006/07 and 2010/11 fiscal years significant variance between forecast and actual net income driven in large part by:	Major investigation of reserving practice in fall of 2010 including calling external auditors Significant investigation of reserving practice in fall of 2011 including calling external auditors and external actuary	MPI retains New External Actuary	A compliment to the PUB A compliment to MPI	
	a cumulative $625 million favourable run-off of PIPP (PUB, 162/11, p. 55) culminating in 2010/11 decreased net claims incurred for basic of $286 M (including $265 in valuation assumptions) (PUB 162/11, p. 55) leading to $62.5 M rebate in 2007/08, $321 M rebate in 2010/11 and $14 M rebate in 2011/12 (CAC 2-62)	The Corporation's recent past claims incurred forecasts have been persistently overstated due to what is now known to have been significant undue conservatism in successive actuarial valuations of fiscal year end claim liabilities, valuations accepted both by MPI and its external auditor. (PUB, 162/11, p. 55)	Positive external auditor comment	Material concerns remain with the AB Other coverage	Does the judgmentally selected tail factor for accident benefits other lead to an overstatement of the proposed IBNR for this coverage? Have the choices of MPI in terms of its selection of IBNR methods by year lead to an overstatement of the proposed IBNR for this coverage?
	(2012/13 GRA) Continued, consistent, cumulative conservatism alleged by CAC Manitoba - alleged to lead to potential additional redundancy	The Board agrees and finds that the assumptions are slightly conservative, but also that they are within the range of reasonableness, and that slight conservatism is acceptable if not preferable. (PUB, 162/11, p. 55)			Are we satisfied that the financial method is the best method for projecting claims incurred for the application year?

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2. Are actual (base) and forecast costs prudent and necessarily incurred? (See PUB 5/12, page 27)					
The Board, in conjunction with the fulfilment of its mandate, has a keen interest in reviewing the Corporation's operating expenses and assessing them for prudence and reasonableness. (PUB 162/11, p. 67)	**Cost Control and Benchmarking** Basic personnel compensation expenses increased by 12.2% in 2010/11 over the prior year, and staffing levels remain high (PUB 162/11, p. 68) 7.73% increase in claims expense in 2012/13 (CAC 1-147) The Board notes the large expenditures on IT and Business Process initiatives that have not seemingly brought about personnel productivity gains. (PUB 162/11, p. 68)	It is the Board's view that the Corporation does not have close controls on its operating expenses. In fact, it does not appear that cost control is a significant priority for the Corporation. The Board would like to be assured that the Corporation is doing everything possible to ensure efficiencies within its operation, and benchmarking is an important part of that. Benchmarking can and should provide a basis for establishing a cost control framework. (PUB 162/11, p. 69)	Record appears to demonstrate no economic increases in salary (TI.8) There appears to be some moderation in claims expense and operating expense per earned vehicle unit in 2013/14 (CAC 2-76) While corporate staff levels appear to have reached a plateau (TI.9), there still appear to be significant numbers of consultants. Sharp divergence in net claims incurred per vehicle versus claims expense per vehicle (CAC 1-148) MPI operating expense and claims expense per earned vehicle unit appear to have risen significantly faster than inflation since 2007/08 (CAC 2-76)	A Compliment to the PUB CAC Manitoba seeks to better understand how MPI has responded to the PUB findings of last year.	Given trends in expenditure control can we reasonably conclude that the proposed expenditures are prudent and necessary? Is additional benchmarking information required in order to assist the Board in making annual determination in terms of whether the actual and proposed expenditures are prudent and reasonable? If additional benchmarking is required, how best can we assist MPI in the process?
	IT Optimization - a projection by MPI that it would spend $71 million in one-time costs and $29 million in ongoing	MPI would best demonstrate to the Board and its policyholders the net benefit to motorists	The Corporation has determined that optimal risk mitigation approaches will	CAC Manitoba is pleased that MPI has identified a more than	As they effect just and reasonable rates for service, are the current and planned

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	costs over the next 5 years for IT Optimization work. The report surprised the Board as at last year's GRA hearing MPI forecast a relatively low level of capital expenditures for the forward forecast period. (PUB 162/11, p. 57)	expected to be realized through these additional capital expenditures. The Board will be monitoring closely the progress, costs and benefits of the projects as they proceed over time. (PUB 162/11, p. 58)	require far less capital resources (from $71.0 million to $45 million resulting in savings of $26 million. (AI.12, pages 6/7) "The comparison to other Team Player organizations saw that MPI's Cost Containment and Business Process Management capabilities were less mature and offer opportunities for MPI to enhance its IT and business efficiency and deliver further value to Manitobans". (Gartner CIO Scorecard –AI.19, page 2	36% reduction in optimization costs compared to the figures presented at last year's GRA.	management activities related to the IT portfolio prudent and reasonable?
	Loss Mitigation (Driver Safety Rating and Road Safety) The Board looks forward to monitoring how the DSR system has, hopefully, resulted in reductions in accident counts and claims incurred. (PUB 162/11,p. 64) the Board is of the view that . . . more "bang for the buck" can be obtained, and hopefully more loss prevention strategies can be identified and pilots "stretched" into ongoing and extended programs when returns become evident. (PUB 162/11,p. 65)		MPI has proposed to finalize the phase-in of the demerit side of the DSR scale. Evidence has been received that there is a substantial body of knowledge relating to road safety that is not being used effectively in any jurisdiction. (Safer Roads, p. 3.	CAC Manitoba has long been supportive of evidence based road safety investments which provide a positive payback for society as a whole and for ratepayers in particular.	As they effect just and reasonable rates for service, are current and planned management activities related to road safety prudent and reasonable?

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			MPI has concluded that there is support for a new and different role in road safety for MPI (Safer Roads, page 24) MPI has acknowledge the support of the PUBM in terms of an active role in road safety. (Safer Roads, page 24)		

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3. Are the revenues and costs of the Corporation properly assigned or allocated between the Basic insurance monopoly and other lines of business?	In Order 150/07, the Board ordered MPI to undertake a cost allocation review, which was filed in subsequent GRA proceedings, having been prepared by Deloitte. In last year's Order, the Board endorsed the cost allocation methodology but did not approve its use for rate setting purposes, on the basis of MPI's refusal to file with the Board specific Corporate-wide financial information. MPI did not provide the requested information in this proceeding. (PUB 162/11, p. 33)	Cost allocation matters are of large importance to Basic rates given the commingling of many expenses, including overhead and staffing as well as the intertwined nature of the Corporation's lines of business. The delivery of service within the Basic line of business is the reason that the Corporation exists, and the Board is mindful that non-Basic lines of business should never be subsidized by Basic. (162/11, p. 69/70)	Basic expenses as a percentage of corporate expenses appear to grow by over 4% between 2012/13 and 2013/14 (PUB 2-17 (b)) Garnter recommends developing an IT business and operating model that is similar to that of an internal service provider using service unit costing (PUB MPI 2-23) MPI indicates that "The Corporation has no intention of creating an IT model whereby service units are charged for specific units. MPI intends to continue to allocate these costs based on the allocation methodology approved by the PUB." (PUB MPI 2-23)	From both an efficiency perspective and a fairness to basic ratepayers perspective, material concerns exist relating to the fair apportionment of costs and revenues between lines of business and within lines of business. The proposed choice of the net claims incurred allocator has a material effect on basic ratepayers (CAC 2-65)	Has the Corporation fully explored whether basic is properly compensated for the revenue generating and cost savings opportunities provided to other lines of business by the close integration of the business units and the basic monopoly? In the absence of full exploration of this issue would it be appropriate to approve the new cost allocation formula proposed by MPI? Are there improvements that could be made to the new cost allocation formula proposed by MPI that might better reflect the revenue generating and cost savings opportunities provided to other lines of business by the close integration of the business units and the basic monopoly?

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4. Taking into account risk, is the Basic line of business managing its revenues, reserves and retained earnings in a reasonable and prudent manner? (See PUB 5/12, page 27) The RSR range is a major, but far from the only, determinant in both rate and rebate decision-making. (PUB 162/11, p. 31) Investment income also has a significant impact on the RSR. (PUB 162/11, p. 72)	In Order 161/09, the Board established a RSR target range of 10% to 20% of net written premiums (vehicle and driver premiums). (PUB 162/11, p. 31) The various mechanisms under which the RSR may be set and about which the Board has heard evidence in the past are the Minimum Capital Test, Dynamic Capital Adequacy Testing and the Risk Analysis/ Value at Risk (VAR) Analysis. (PUB 162/11, p. 31 and 32)	As stated in Orders 150/05, 156/06 and reiterated in subsequent Orders the Board's view of the adequacy of the RSR includes consideration of Basic retained earnings, segregated reserves and the RSR. (162/11, p. 30)	MPI proposes that the RSR target be based upon its DCAT analysis and that other mechanisms be discarded. Professor Simpson on behalf of CAC proposes a considered analysis of the strengths and weaknesses of each approach.	The DCAT analysis shows some improvement. However, the $200 M scenario can best be described as designed "to protect against the type of risk that MPI would face if modern governments and their economic advisors had learned nothing from past history and had responded after 2008 in the same way governments did in the 1930s to a stock market crash."	Given strides taken in equity risk management is it reasonable to expect that the biggest risk faced by Manitoba Public Insurance is risk related? Does this suggest that risk management related to MPI equities is not optimal? Taking into account the opportunity cost associated with excessive levels of reserves, other risk mitigation tools, the reality of the Corporation's status as a legislated monopoly and the relative strengths and weaknesses of each approach, what is the best approach to ensuring that the RSR is set in a manner that is: credible, transparent and understandable?
	MPI has adopted various target allocations for the various asset classes within its investment portfolio. While allocation options were provided and modelled by AON Consulting, with its report filed at the 2009 GRA, AON's recommendations were not fully adopted. (PUB 162/11, p. 27)	Investment income also has a significant impact on the RSR. (162/11, p. 72) The Board notes that some investment diversification has occurred, and that diversification may be	MPI resists discussion of the issue of investment portfolio composition and risk stating: "The Minister of Finance is responsible for analyzing the composition and risk of the investment portfolio."	The composition of the investment portfolio has a significant impact on the risks associated with the basic program and should be a central component of risk diversification.	Given its effect on the RSR and revenues, has the investment portfolio been designed in a manner that optimally balances risk and return? To the extent that MPI denies the PUB information essential to

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		expanded on in the future. MPI should constantly review its asset mix and act to avoid both wide fluctuations and inadequate yields arising out of its portfolio. (162/11, p. 72)	PUB (MPI) 1- 8		understanding both the risk faced by the Corporation and mechanisms to mitigate risk, should an adverse inference be drawn that may influence considerations of the appropriate magnitude of the RSR?
5. In each class of ratepayer, and each ratepayer within their respective class, bearing a fair and reasonable share of the costs they bring to the system? (See PUB 5/12, page 27)			CMMG 2-9 through 2-14	CAC Manitoba will monitor the questions of the Board and other interveners.	
6. Is the proposed rate just and reasonable? (See PUB 5/12, page 27)	CAC Manitoba and the PUB have consistently rejected budgeting for a loss in rate setting		MPI projects a loss for 2013/14 of roughly $5.6 M. (TI.13) Given the impact of staggered renewals and modest positive net income projected for 2014/15 MPI argues that it is not budgeting for a loss.	CAC Manitoba notes a forecast loss for 2012/13 of $4.7 M. (TI.12)	In considering whether the Corporation is budgeting for a loss should consideration be given to only the test year (2013/14) or should reference also be given to current year forecast (2012/13) and to the projection for the year beyond the test year (2014/15)? If more than the test year is considered should more weight be given to the current year and test year?