CLOSING ARGUMENT

Manitoba Public Insurance

2013/14 General Rate Application

APPLICATION

In this GRA, MPI has applied for four specific items:

1. No overall change in rates
2. Approve the final step in the DSR demerit surcharges
3. Approve the new cost allocation methodology for rate making purposes
4. Adopt the DCAT methodology to determine the Basic Autopac RSR target, and for 2013/14, an RSR target of $200m.

RATES

This is the 14th time in 15 years that MPI has held the line or reduced rates. The financial condition of the basic compulsory program is sound, and will continue to be, through the use of a ratemaking methodology that is actuarially sound and statistically driven along with strong and transparent forecasting processes.

Out of 25 rate applications, the PUB has approved 19 overall rate levels sought. In a further five applications, the amount approved has been less than 1.2% from that sought by MPI. In the one remaining rate application, the PUB granted a higher rate than that applied for by MPI. This is an incredibly strong record and should be something the Board, the intervenors, and the Corporation are proud of. It shows that all parties have achieved a certain level of consensus and convergence in rate setting and the applications brought before the Board have satisfied the criteria of fairness, actuarially sound, and statistically based.

NO OVERALL RATE CHANGES

The Corporation is seeking no overall change in premium revenue for rates effective March 1, 2013. This has been determined by the longstanding, PUB approved rate making methodology as encompassed in the rate filing. The goal accepted by all parties, including the PUB, is for Basic to break even financially. Break even financially means averaging out the two years of net income for 2013/14 and 2014/15, recognizing the effect of the staggered renewals, and forecasting a net income of plus or minus $10 million out of total earned revenues of $793 million in 2013/14 and $833 million in 2014/15. The Board heard forthright evidence of the potential variability of that forecast – due to hail, investments, and claims costs, amongst other things.

How was the 0% change in rates determined? In an abbreviated explanation, the corporation forecasts its expected costs and revenue for the future period covered by the rating year and then determines the impact of those costs and revenues, on net income, with no rate change. The difference between required income from rates and what would be received without a change determines the indicated rate change. This year, the actuarially indicated rate change is- 0.3%, which was rounded to 0%.

TI.14 indicates that, the Basic retained earnings are forecast to be:

$205m	2012/13
$199m	2013/14
$208m	2014/15

As indicated in the hearing, this projection is without future rate decreases and therefore indicates an RSR level that aligns closely within the DCAT target of $200m within this period.

And looking at the net income for those respective years at TI.15:

$-4.6m	2012/13
$-5.6m	2013/14 the year of the application
$8.3m	2014/15
$22.5m	2015/16

The years with -$5.6m and $8.3m net income are basically break even, followed by a healthy year (that starts three years out from now) of $22m projected net income. For rate setting purposes we must add the net income from the two fiscal years covered by the applied for rates, and then divided by two. So we are looking at a small positive net income over the two years (2013/14 and 2014/15) affected by the 2013 rates. This is what drives that -0.3% actuarially indicated rate -- MPI could have applied for a -0.3% rate decrease, but chose not to due to the small amount. Tr 386-387

In looking at what is break even, it is necessary to keep in mind that a 1% change in overall rates yields a revenue change of $7.8m. Of course, rate stability is paramount for Manitobans and that necessitates a long term view of the net income and retained earnings. In 2015/16, with a forecast net income of $22m, the Corporation would not, according to Ms. McLaren, seek approval of rates that would generate $22m net income. Tr 387. That is, of course, with all other things being equal. The same, she indicated, would be reflective of the retained earnings – namely, MPI would not likely apply for a rebate one year and then seek an increase the next year.

Based upon the ratemaking processes that have been long established, along with the stability of the outlook which has been exhibited over a number of years, it is submitted the PUB should approve this 0% rate change.

Fresh Start

The Corporation appreciates the comments from CAC with respect to its desire for a regulatory fresh start. In our minds, this hearing was indeed a fresh start in many ways and we appreciated the tone of the questions from Board counsel and intervenors, we appreciated sticking to the jurisdictional mandate of the PUB as per the Crown Corporations Public Review and Accountability Act, and we appreciated the appropriate nature of the questions and challenges to the evidence. At MPI we also highly value the questions of the Chair and would welcome any from other panel members. It is extremely important for the MPI witnesses to understand how the Board is thinking about the evidence and we can help address any concerns, issues, or doubts that the members might have. Better information yields a better Order.

In making that statement, you might notice use of the word "better" to describe information. I did not use the word "more" information.

And that is where MPI differs from CAC fundamentally.

Does Process Matter?

The title of CAC's argument is "Does Process Matter" A Regulatory Leap of Faith". The consistent theme throughout Mr. William's argument is for process – indeed, he even states at the beginning of his argument that the biggest issue is to get the process right now. With all due respect, I would have thought the biggest issue was to set rates, which is why we are here, as the legislation dictates.

Apparently, until this emphasis on process is satisfied, MPI is to live in this regulatory limbo or no-man's land, in which nothing is seemingly approved by the PUB. While MPI is certainly pleased with the CAC recommendations to support MPI's application of no overall change in rates and no rate rebate to be issued, there has to be finality to the issues the Board has been dealing with for years now.

Let's discuss the variety of issues and topics for which CAC wants to expand and extend the process:

1. More process relating the review of unpaid claims liabilities. Ostensibly this is for further refinement and review. What we can say is that every year there will be

differences in the review of unpaid claims liabilities – actuaries get new processes and standards, the data is viewed differently, interest rates go up or down, the PIPP program changes, there will be IBNR releases, there will be shortfalls. We expect that every year the review of unpaid claims liabilities should be analyzed in this forum.

2. More process is required to address concerns on the interest rate PfAD and Accident Benefits Other, which is a component of the unpaid claims liabilities. The previous issues apply to this too.

3. Obtain data from other no fault insurers or WCB and have that reviewed within the PUB process, because CAC indicates there is uncertainty and a material impact of uncertainty on ratepayers until this is accomplished We disagree..

4. Focus on developments in terms of productivity/performance indicators. MPI to propose a productivity benchmark. This is in the context of operating and claims expenses. Again, CAC wants a process to establish productivity indicators and then review and test these afterwards. With all due respect, although productivity indicators may be an interesting item for the Board to review, ultimately, it factors very little into ratemaking, and is really a tool for management to review the operations of the corporation – not the PUB. Nevertheless, CAC is actually recommending the MPI propose a productivity benchmark in the next GRA,

which, I argue, then CAC will likely critique in some fashion and pick away at over the next several years of GRA hearings as per the process.

5. Revise the DCAT since it is not ready for prime time. The DCAT has now been prepared in-house, from a true basic Autopac perspective for 3 years. This is now Professor Simpson's third appearance before the PUB on the RSR methodology. The Operational Risk Analysis was first prepared in 2000 and has been the subject of almost every hearing since then. This process to determine an adequate RSR has occupied likely more time than any other topic since the PUB has commenced rate setting in 1989. I know this to be true since 1994, my first GRA, as an articling student, when I was junior to the Board Counsel. And now CAC wants even more process on the methodology!

6. Host a technical conference on the DCAT. Another process.

7. Cost allocation is to be further reviewed. The PUB directed MPI to review its cost allocation methodology in 2006. Since the panel members are relatively new I will give you an idea of how much time and money has been spent on that. There have been 812 pages of transcript, the Board has heard twice from Richard Olfert of Deloitte, and twice from Messrs. Kowalchuk and Parkinson on the issue of cost allocation. MPI has already paid Deloitte approximately $280,000 for their work on cost allocation. The Board has heard ad nauseum from the MPI panel members on this over the past four GRA hearings. Yet Mr. Williams argues that "MPI's analysis continues to be impoverished". And Mr.

Williams wants to still fill more transcript pages on cost allocation when the difference between the two methodologies is now down to 0.075% of a rate.

8. For road safety MPI is to produce a baseline of survey of who is doing what and the data available, along with a number of proposals for future developments. While all very interesting, my comment in that regard is what does this have to do with the approval of Basic rates and why should the Board and intervenors be engaged in this at all? The Government will address and decide the future direction of road safety within the province.

So, does process matter? Of course process matters; but not process for the sake of process in which there is no finality, matters are reviewed and debated endlessly, and the Corporation is left in a state of uncertainty, and the hearings expand every year to fill an increasing number of days and endless Information Requests.

Now is the time for the Board to make decisions on the above issues and put them to rest so to speak and take MPI out of this regulatory limbo in which MPI's proposals are endorsed, but cannot be utilized for rate-setting purposes. In particular the cost allocation and the DCAT methodology ought to be approved.

FORECASTING IN GENERAL

The forecast is, of course, integral to the prospective ratemaking process. To determine its forecast, MPI undertakes many different approaches. To forecast interest rates, MPI relies upon the median forecasts of various major banks and professional forecasters – it does not attempt to forecast this itself. Tr 939-942

Estimating the future claims is incredibly hard and must take into account weather, for instance, since winter has the highest frequency or, conversely, several summer hail storms can wreak havoc on those vehicles in its path. The claims forecast book is located at TI.17 and lists the economic assumptions and model descriptions and methodology employed in the claims forecast. There is the PIPP, or bodily injury, forecast and projections in which costs are projected on the different lines of coverage (income, PCA, rehabilitation costs, etc) sometimes out for 40, 50, 60 years. And the physical damage forecast contains projections for coverages as disparate as collisions between autos, wildlife collisions, fire, theft, vandalism, etc.

Even with all of these challenges, the net claims incurred forecast has remained very stable over the past year with an average increase of approximately 0.75% over the rating period. The stability of the claims forecast is the key reason for the overall 0% rate indication in 2013/14. LJ PFT, p.3

For physical damage claims of vehicles, MPI pays to body shops to repair and for vehicles rendered total losses, approximately $450m per year. There is less than 1% variance between the forecast and the actual. Tr 152 This is an incredibly high degree of accuracy in the forecast. Of course, as acknowledged by Ms McLaren, these are what is known as short tail claims; whereas the long tail claims (20, 30, 60, 70 year bodily injury claims) are, obviously much more difficult to forecast. Tr 152 – 153

For the forecast period, the Corporation has revised its forecasting methodology for volume and upgrade. The projected volume and upgrade factors will now be based on Highway Traffic Act (HTA) units and upgrade rather than overall volume and upgrade. Non-HTA units, which are made up of trailers and ORV's, represent 21% of units but only 1% of vehicle premiums. The increasing number of non-HTA units was distorting the Corporation's upgrade and volume calculations. This year's forecast assumes that the combined growth from volume and upgrade (excluding DSR) is 4.29% per year (2.50% HTA upgrade, 1.75% HTA volume) compared to 4.81% per year (2.25% upgrade, 2.50% volume) last year. This change translates into approximately $8 million less revenue in 2013/14 and $14 million less revenue in 2014/15 compared to using last year's assumptions. (Luke Johnston's pre-filed testimony, page 4, last paragraph)

You heard testimony that the incredibly high growth in trailers and ORVs was distorting the volume growth numbers, especially when these types of vehicles only contribute to 1% of premiums written due to their low rates relative to other vehicles. The inclusion of the trailers and ORVs meant that the actual volume factor was consistently higher than MPI's projection. Removing the trailers and ORVs should enhance significantly the Corporation's forecasting in this regard. Tr 389-392 The effect of this on net income, at the end of the day, is pretty minimal – recasting the volume factor from 1.75 to 2.25% would only yield an additional $500,000 in net income. Tr 395

MPI also pulled the non-HTA vehicles out of the upgrade factor, noting that it was also having the same effect. Tr 397. Again, the evidence is to have the upgrade factor retained at 2.25%. Whether you change upgrade or volume factor, then the TI.2 will still be applicable since they are set on a break even basis. If the individual rates are set on a break even basis, the net income will be the same regardless of the number of vehicles or the composition of the fleet. .The IR outlining that the impact to net income if the upgrade factor were altered from 2.5% to 3% is approximately $5m is erroneous because it excludes the impact on claims incurred, which, of course, would not be the case.. tr 407-413

REVIEW OF UNPAID CLAIMS LIAIBLITIES

The unpaid claims liabilities are set out in the external actuary's report. It might be difficult for the Board members to believe, but up until last year, the review of unpaid claims liabilities attracted very few questions or attention. As shown in AI.10, the October 31, 2011 Appointed Actuary's report resulted in a reduction in claim liabilities of $43.1 million, or 3.2% of total claim liabilities, relative to the Corporation's booked value. The main reason for the reduction was due to the removal of an assumed tail 'load' for Weekly Indemnity coverage (i.e. assumed additional growth in claims incurred for lifetime injury claimants beyond the Corporation's observed experience).

The corporation lived up to its commitment made at last year's hearing and reconsidered whether the 6% load on Weekly Indemnity was required, took the position it was not and this was validated by the Appointed Actuary. All parties have to agree this eliminated a material source of conservatism. With respect to the 6% load in Accident Benefits – Other, I think Ms McLaren was quite clear when she testified that she is not entirely convinced that Mr Johnston and the Appointed Actuary haven't gone too far, and swung the opposite way. Mr Johnston told you that significant numbers of catastrophically injured claimants are receiving no Personal Care today and just as many who ARE receiving payments are receiving a fraction of their entitlement. There is simply no justification for Mr Williams' view that there is unwarranted conservatism in AB Other.

Another significant change in the October Appointed Actuary's report was to increase the Corporation's interest rate provision for adverse deviation from 1.00% to 1.25%. The Appointed Actuary based his decision on the current inflation rate AND the current average yield of our bond portfolio as of October 31, 2011. It is his view on this relationship between low yields and inflation that is relevant.

The impact was an increase in unpaid claim liabilities of $34.0 million. As noted by Mr. Johnson in cross examination, the external actuary made a case for this, laid out his reasons, and it was seen as reasonable by MPI's Chief Actuary. Tr 526 . Mr. Cheng noted in his October 31 review at AI.10 that the 0.67% real return was the lowest ever experienced at the time of a valuation. The interest rate PfAD for actuaries must be between 0.25% and 2.00%. 1.25% is still in the mid range of this provision.. PFT Johnston

The impact of all other changes in assumptions from the October 2011 Appointed Actuary's report was a $21 million decrease in liabilities relative to booked values. The majority of this impact was due to updating the loss development assumptions to be reflective of the latest experience. There were no changes to assumptions in the February 2012 Appointed Actuary's report other than to update the report for the latest observed data. The February report indicated a decrease in unpaid claim liabilities of approximately $1 million.

With respect to PIPP forecasting, Mr. Johnston acknowledged a need for an improvement in forecasting to show a much more consistent relationship between actual and forecast in PIPP, especially after the last few years of IBNR (Incurred but not Reported) releases. Tr 427. Measures have been put in place to ensure improved forecasting. (Transcript pages 921 - 922) To summarize this exchange, Mr. Johnston did admit that there was a bias in the past few years based on the undeniable evidence of favourable incurred outcomes. He stated this problem had been fixed over the past few years through the very significant adjustments made to claims liabilities.

The large actuarial releases were also the subject of extensive cross examination last year. What we can say now is that new data exists, new methods have been deployed, and there are new actuaries – both internally within MPI and the external appointed actuary. Finally, there is no level of undue conservatism in the review of unpaid claims liabilities.

When questioned by Board counsel as to the level of confidence the Corporation has in the most recent evaluation estimates of unpaid claims liabilities, Mr. Johnston answered, "I mentioned earlier about how we changed our reserving methodology in 2005. I'm very comfortable with the emerging experience coming out of those changes. We do have an IR that shows clearly that the reporting has been much more consistent under the new methodology. I do strongly believe that we have selected best estimates based on the available data that we have. I don't anticipate any of those numbers changing significantly." Tr 484 We urge the Board to accept this approach now based upon the evidence.

CAC tried to make much of the possibility of future release from the unpaid claims liabilities. However, this was disputed by Mr. Johnston. The most recent evidence counteracts this allegation. Undertaking #3 provided the most recent run off of claims liabilities. For the liability review as at April 30, 2012, there was an increase in PIPP unpaid claim liabilities of $16.8 million – in other words, the indicated PIPP IBNR was $16.8 million higher than booked (Meaning there was no undue conservatism here). For the liability review as at July 31, 2012, there was an additional increase in PIPP unpaid claims liabilities of $13.8 million – i.e., the PIPP IBNR was $13.8 million higher than booked.

A summary of the July review of unpaid liabilities was provided by way of undertaking and filed as Exhibit 19. The policy liability valuation resulted in an increase in PIPP unpaid claims liabilities of $13.8m – ie, the indicated PIPP IBNR was $13.8m higher than booked. This was using the same assumptions and methodology as with the February 2012 valuation.

In conclusion, there is no evidence for the PUB to find anything but that this actuarial review is reasonable and forms the basis for just and reasonable rates.

COST ALLOCATION METHODOLOGY

Every organization that operates more than one line, makes more than one product or has more than one location necessarily uses allocation policy to properly divide its costs, assets, and so on. In particular, rate setting regulators everywhere in all industries rely on allocation policy to ensure the costs charged to the line of business subject to the regulatory oversight are appropriate. Nothing that MPI is doing is that unique – the NEB, CRTC, OEB, BCUC, all deal with their regulated entities that have multiple lines of business.

The Deloitte methodology is much superior to the pre-existing methodology, it offers a more robust way to examine costs, and it uses the beneficiary of the services to determine allocation. The PUB endorsed it as a methodology in the recent past, yet declined to implement it. So, the Corporation has resorted to preparing the rate filing on the basis of the less desirable PUB approved cost allocation methodology.

Net claims incurred should be used as the allocator of shared claims handling costs instead of gross premiums written. It more fairly reflects the cost of providing Basic insurance service and provides reasonable results that are more readily understood. The particular benefits of net claims incurred are:

- meets the criteria set by Deloitte - it is an objective easily obtained driver of costs
- more closely aligned with the expenses it is allocating from a timing perspective
- reflective of the activity generated in handling the claim
- will not fluctuate based on rate setting policies
- not impacted by policy decisions on the profit margin to be earned on competitive lines of business
- if it increases it is because of higher severity of claims and/or higher frequency of claims, both of which impact the effort and expense in administering the claim

As stated by Ms. Reichert, “We believe that the new updated methodology is the most fair and reasonable allocation methodology, and it appropriately reflects cost causality by using net claims incurred. The use of a four year rolling average for the customer contact ratio and net claims incurred will ensure that future allocations do not swing significantly from one year to another. Tr 298-299.

While it is difficult to disagree with Mr. Williams that reasonable arguments could be made for and against any particular decision at a detailed level, and that reasonable persons could come to different conclusions tr 1027, two pre-eminent national accounting firms agree that net claims incurred is the more appropriate and reasonable allocator.

As KPMG stated in their October 2010 assessment of the Deloitte methodology using net claims incurred:

> "… we did not observe any bias in the application of the cost allocation methodology. This means we found no evidence that the allocation of costs is skewed to achieving a particular result or outcome – this is an important element of our assessment of reasonableness."

The Net Claims Incurred allocator, therefore, more fairly reflects the cost of providing the basic insurance service and provides reasonable results that are more readily understood. As stated in the Deloitte June 30, 2009 report:

> "Net claims incurred by line of insurance were selected as a reasonable allocator as it provided <u>the most reasonable comparator of actual business activity</u> required to service customers under each insurance line of business." AI.16, p 6 and 7

In Mr Williams' argument he clearly encouraged this Board to disregard what is most reasonable and, instead, use premiums written, as "it more accurately captures the overall relationship than the cost allocator. And it does so because at least to a certain degree it takes into account the benefits inuring to Extension form the Basic monopoly in terms of the revenues." Tr 1727 Not only is this contrary to the principles of cost allocation, it ignores the reality explained by Ms McLaren.

On page 82 CAC Exhibit 13, Mr. Williams has only included one part of a response Ms. McLaren made in reference to the synergistic relationship between Basic and Extension operations. He quotes Ms. McLaren, “Autopac Extension, particularly, does have revenue generating advantages by being associated with Basic”. (TR 1042) The rest of Ms. McLaren’s response which he did not include went on to say:

> “I – I will not agree that they have any real cost saving opportunities. I think that Extension business would run fundamentally differently if it was not part of this larger system. But it does have revenue generating opportunities.” (TR 1042)

Ms. McLaren continues:

> “But I would really make the case that that also helps Basic rate payers.”
>
> “We’ve more than doubled the size of the Extension book of business, which has a significant cost allocation impact, which means that Basic is not paying anywhere near as much as it used to.” (TR 1042)

In reality, this becomes a circular argument:

> Basic gets advantages from Extension
>
> Extension gets advantages from Basic

It is important for the Board members to recall that out of more than $1b worth of expenses incurred by MPI annually, only $220m of those expenses are subject to some form of allocation. To provide you with the specifics on this, the total normal costs of the corporation are $1,068,000,000 for 2012/13, of which $686m is directly assignable to

Basic. Ex 11 Only $170m or about 20% is allocated to Basic. Of the $170m allocated to Basic, only about 75% would be allocated on the basis of net claims incurred.

The financial effect on Basic, if the PUB were to adopt the new methodology would be less than 0.1% AI.16 (Attachment B), which is not a lot of money. The GRA net income is forecast to be -$5,614,000; compared to a net income of -$6,137,000 if the new methodology were to be applied.

MPI can assure the Board that if it was to order that 2013/14 rates be based on the Deloitte methodology with net claims incurred, not only would the Corporation fully welcome such direction; it could implement that direction quickly and effectively in time for the March 1, 2013 rates.

OPERATING EXPENSES AND CAPITAL EXPENDITURES

The Corporation does not judge the expenses it incurs based upon a profit margin or on consumer price indexes. The Corporation judges its expenditures based upon its Value Equation:

PRICE + COVERAGE + SERVICE + ACCESS = VALUE

If the expenditure results in “value for all Manitobans,” there is value in the expense being incurred.

The Corporation is concerned with providing easily attainable coverage and services that do not discriminate. Manitobans' coverage is based upon residency, first and foremost. Coverage is not on arbitrary discriminatory factors such as age, gender, marital status, or education. No matter where you live in Manitoba, you must have access to the same service that is available to every other Manitoban. Ninety percent of all Manitobans live within an hour of a Service or Claim Centre. (Annual Report, p.11)

The Corporation recognizes that Manitoban's needs and expectations continually change and we pride ourselves on constantly evolving to deliver high levels of service and value that meet those needs. To be relevant to meet Manitoban's changing needs the Corporation has to change as well. Ninety-two percent of Manitobans who have completed a transaction with the Corporation are satisfied with the service they received. (Annual Report, p.11) The Corporation recognizes it must constantly improve.

The coverage the Corporation provides is set by the Legislature. The Corporation believes that Basic Autopac Insurance is among, if not the most, comprehensive and generous coverage in Canada. Moreover, all the access, service and coverage is accomplished within the component of the Corporation's value equation that is within the jurisdiction of the Board – Price. The Corporation provides access, service and coverage to all Manitobans at an affordable price. This equals value for all Manitobans.

Since 1994, the national average for the cost of insurance coverage has risen 2.4 times higher than in Manitoba. (Annual Report 1994) The Corporation will provide continued value to all Manitobans without the necessity of seeking a rate increase.

The total projected costs for the 2013/14 fiscal year, excluding capital expenditures, is $887,095,000 [TI.15A]. Manitobans are only being asked to pay $793,247,000 [TI.15A] in the form of projected premiums to cover these costs. The majority of these costs $638,142,000 [TI.15A] will be in the form of claims payments. Operating Expenses which allow the Corporation to provide coverage through access and service to all Manitobans, is projected to be $194,923,000 [TI.15A Total Basic Expense].

The Corporation continues to manage all operating, maintenance, and capital expenditures. MPI believes it has shown in the evidence, both written and oral, that it makes these expenditures with the appropriate degree of fiscal prudence, whether it is staffing numbers, compensation amounts, benefits, data processing, or postage. The test is whether the expenditure is a positive contributor in the Corporation's Value Equation.

It is important to remember that MPI is a Crown Corporation and all that that entails, especially in regards to direction. The Government did not direct MPI to increase expenses; neither did it direct MPI to constrain or contract expenses, with the exception of the mandate for collective bargaining. The Government has been well aware of the initiatives underway at MPI and has supported their continuation. Although the initiatives cost money, they add value in the Corporation's Value Equation.

The single largest component of the Corporation's Operating Expenses is the compensation paid to its staff. The Corporation is in the final stages of collective bargaining, and so cannot advise as to the outcome. But, the Corporation can advise that the forecast includes a 0% change in compensation amount for the next two years, and there is no need to alter this. As was indicated in the hearing, the Minister of Finance has provided direction to all Government Management that there are to be no increases in negotiated collective agreements. Within MPI, the 0% change in compensation will apply to staff that are both in-scope and out of scope of the collective agreement.

The Corporation clearly demonstrated that it actively manages it expenditures in a fiscally prudent manner, constantly seeking ways to find greater value for Manitobans. This is no more evident than the solution the Corporation found for its IT Optimization. Last year, the Corporation was anticipating having to spend $71 million in IT Optimization. Subsequent to last year's GRA, the Corporation found a solution partnering with IBM that will result in a $26 million savings for the IT Optimization project. AI.12, p. 7 The Corporation exercises the same rigor in constantly seeking improvements throughout its operations to improve the value Manitobans received for the expenses the Corporation incurs.

INVESTMENTS

As all are aware, the Department of Finance has responsibility for the investments of the Corporation. Ms. McLaren provided evidence in her direct examination that the Minister of Finance, and in particular, the Assistant Deputy Minister controls the investment portfolio of MPI. Perhaps the extent of that control was surprising to the Board members. For instance, Finance decides on the classes of investments it will place MPI's monies into, Finance hires and fires the equity managers, Finance makes the decisions to and actually does invest MPI's monies into infrastructure investments, Finance is the bond manager for the Corporation, and the Corporation actually forwards its monies to Finance for Finance to invest. Tr 158- 167 In response to a question of Board counsel, it was noted that it was a decision of the Minister of Finance to not invest MPI's monies into EAFE investments. Tr 593 These are just a few of the examples of the total control the Minister of Finance, largely delegated to the Assistant Deputy Minister, exercises over the investment monies of the corporation.

The corporation has full confidence in the Minister of Finance and the Assistant Deputy Minister in management of the investment fund. The PUB should note that the fund has performed better than most, that in particular the bond manager has provided great values. In the past ten year period, both the MPI total portfolio and the MPI marketable bond portfolio were in the first quartile, where the first quartile is the top 25% of funds in MPI's peer group. PUB 1- 8 Near the end of proceedings the Chair asked the question as to whether Manitobans would support a rate increase made necessary by investment decisions made by Government. We suspect Manitobans would have little patience for rate increases made necessary by anyone's poor investment decisions – decisions made by Government or MPI's. One of the issues that led to the creation of Manitoba Public Insurance was the constant outflow of capital from Manitoba to the head offices of insurance companies elsewhere in Canada and the world. For forty years, the government has exercised its discretion and retained tight control over the investment assets of this Crown corporation. Not only is this unlikely to change but I would argue that the Government believes it will "wear" any investment mistakes regardless of whether it retains legislative authority and that may very well be why it intends to KEEP such legislative authority.

Asset Liability Matching

The primary purpose of MPI's investment portfolio is to fund the Corporation's short and long term liabilities as they come due. An asset liability modeling study models the assets and liabilities of MPI and determines the optimal mix for the portfolio in order to mirror the changes in values of the liabilities. This ensures that the assets are able to fund the liabilities even when interest rates or the economy change significantly.

The corporation has gone a step further by specifically matching its bond assets with its claims liabilities, both of which are highly interest rate sensitive. As explained by Mr. Johnston at tr 657, this really acts to limit the variability in net income considerably.

This stability is crucially important for rate setting purposes. The more stable net income is projected to be, the more stable rates will be.

Cash Being Held

Evidence was provided during the hearing that the investment portfolio currently contains a higher amount of cash than the desired or target allocation. Ms. McLaren explained the dual and sometimes competing priorities of purely matching assets and liabilities vs, working to maximize returns.

> “Unlike the people at MPI who worry about our claims liaiblities, our bond manager is hoping for one of those big spikes in interest rates that you talk – talked about. And one of the things he’s thinking about is, you know, the extent to which it makes sense to continue to sit on more cash that we would normally have in anticipation of an upward move in interest rates.
> It’s – it’s a difficult question and something that, you know, we do talk about and consult with because we really take great comfort from the fact that we have this matching to, you know, about the 80 percent that you mentioned. So one could take the position that well, you know, if you’re matched to that extent don’t - don’t even worry about what return you’re going to get on the bonds that you purchased, because, you know, they’re matching your liabilities.

> But – but Mr. Gibson is – is, you know, still the investment fund manager, he's responsible for it, and he really wants to balance that perspective with really really trying to anticipate how to possibly get the best returns. Corporately, you know, we're comfortable with the matching, but there – there's always that kind of dual side of it. Tr 531-532

It was explained to the PUB that the Department of Finance was holding onto that cash in anticipation that at some point, interest rates will rise. At that point the Department of Finance would be in a position to buy more bonds because it would have foregone purchasing them today at lower interest rates.

As Ms McLaren pointed out, that while the fund forgoes some income while holding extra cash, that would be more than exceeded by purchasing bonds after even a small interest rate increase. In other words, the gain in higher returns, it is believed, will quickly outweigh the opportunity cost of holding a bit more cash for a short period of time.

Accumulated Other Comprehensive Income

AOCI reflects the accumulated income or loss from unrealized gains or losses on available for sale equities. Once a gain or loss is actually realized, the gain or loss is transferred to regular income. It is for this reason that only excess retained earnings above the RSR, and not the AOCI should be considered when decisions are made regarding rebates and surcharges. Positive AOCI does not represent “cash in the bank” nor does negative AOCI warrant a surcharge to replenish it. However, as suggested by the external actuary, when assessing the financial strength of Basic and whether it has sufficient assets to meet its liabilities, then including AOCI is appropriate from an accounting perspective. Because AOCI does not represent “cash in the bank” it would not be appropriate to consider it when deciding upon any potential rebate.

Investment Income Forecast

What is important for the PUB not to lose sight of for ratemaking purposes is the forecast of investment income. In my direct examination, I asked Ms. McLaren,

> “In your opinion, with respect to investments, Ms McLaren, what does the PUB require knowledge about for the purposes of setting rates for Basic insurance?
>
> “Ms. Marilyn McLaren: I believe the answer to that aligns really well with what MPI is responsible for when it comes to its investments. And that’s really the investment forecast, the investment income forecast.
>
> That’s not something that the Department of Finance plays much role in. It is our responsibility to understand the investments well enough to be able to build a reasonable forecast of investment income.
>
> This is a critical part of the revenues flowing into the Basic Autopac program because it is a system designed to break even, because it is a system that is not expected to provide any sort of return to shareholder.

> The investment income is – is a critical part of the revenue as much as driver licence premiums and – and vehicle premiums.
>
> So we need to have strong robust processes for – for forecasting investment income. And, in turn, that would be what this Board would really – I believe, would need to assure itself of, that our forecast investment income is – is reasonable and actually constitutes a reasonable basis, as with the other forms of revenue and claims forecasting, of predicting the revenue that we need, the rates that we'll need to charge, and therefore, be able to approve the rates that we submit to the Board." (Transcript pages 168 – 169)

The Corporation is satisfied with the current rate of return of its investment portfolio and has forecast investment income of $88m for 2013/14. At this point, there is no evidence in the markets that would cause MPI to revise this forecast.

Diversifying Risk in the Investment Portfolio

CMMG was straightforward in its argument that since the Minister of Finance was responsible for the investment portfolio, then if he made a mistake (ostensibly an unforeseen market decline) then the Government should, in effect, reimburse MPI. CAC was more subtle in pointing out "The irony MPI is claiming the RSR needs to be over $200m to protect ratepayers against risks flowing from equities which it asserts the

Province has control over (begs question of whether ratepayers should be on hook for risk allegedly created by choices of the province", CAC p 76

Let's turn that argument on its head for a moment. There has been ample evidence brought forward to the PUB that the MPI investment fund has been well served by its manager at the Department of Finance. In particular, the bond portfolio has performed in the 1st quartile over the last year, last 5 years, and last 10 years compared to their peers. I suspect the intervenors are not equally arguing that this money should belong to the province. This argument of using taxpayer dollars to make ratepayers whole for declining equity markets is wrong on so many fronts. The Minister of Finance has set a prudent course for MPI's investments and just as MPI ratepayers are beneficiaries of investment income in good years, through healthy investment income that is used to keep rates down or is even rebated to the ratepayers, those same ratepayers must bear the downside of the equity markets.

METHODOLOGY FOR CALCULATING THE RSR

MPI welcomed last year's PUB Order that indicated it would reconsider the methodology for calculating the RSR. After hearing all this evidence, the PUB might be re-considering its offer!

No Confusion in the Purpose of the RSR

The purpose of the RSR is to protect customers from rate increases made necessary by unexpected events or losses arising from non-recurring events or factors. Period. This definition has remained constant for quite a number of years and all have been well served by it. Contrary to CAC's argument, there is no confusion amongst the MPI witnesses. There are many permutations and combinations on how and when the RSR could be used which are merely elaborations on the above defined purpose of the RSR. MPI panel members did not think it would be helpful to answer every question on the use of the RSR with a robotic recital of the defined purpose and so tried to thoughtfully discuss and elaborate on the RSR. There is no confusion. MPI is not seeking to have the defined purpose revisited.

Over the past several years, MPI and the PUB have had differing perspectives on the appropriate target amount of the Basic RSR. This year, the Corporation sincerely hopes that both MPI and PUB will finally share the same perspective.

I think everyone here agrees that the greatest current risk faced by the Corporation, for the purposes of the RSR, is the equity markets. Ms McLaren explained:

> "But it's very, very rare, if it happens at all, for an automobile insurance company to have annual premium of – I guess the Basic plan is about seven (7), $800 million annual revenue, when our outstanding liabilities for that program are over $2 billion.

Every year, the liabilities will get bigger for probably another thirty (30) years or so, until we actually get to a steady state, which is not expected to happen for as much as fifty (50) years after the no-fault program started back in 1994.

So the liabilities continue to grow, which means our investments will continue to grow, which means if you have any equity investments, for example, there will be more dollars invested in equities every year, even if we don't change the percent of allocation that goes towards equities.

So we have some challenges. We, everyone in this room, have some challenges dealing with and properly balancing the impact of such a large pool of outstanding liabilities. The Minister of Finance has responsibility to balance the investments that offset those liabilities. We have no unfunded liabilities in this program.

So it is strong; it is fully funded. But the balance – and that's one of the points that you'll hear from Mr. Johnston later in these proceedings, when you look at methodologies to determine on what basis you establish an RSR, and the Corporation says, Well, percent of premium is, like, completely irrelevant.

If what you need to establish is a reserve to deal with unexpected future events, your risk is in your liabilities. Your risk is this continuing for a decade or two (2) to go, a continuing growing liability and growing investments to offset that liability that far, far exceeds our annual revenue." (Transcript pages 153 – 155)

“Ms. Kathy Kalinowsky: To calculate the percentage of premiums written is an (sic) extremely simple and transparent. Why shouldn't the PUB stick to this approach to calculate the RSR? And in the context of the RSR, can you explain whether there is a relationship between premium written and risk?

Mr. Luke Johnston: You're correc -- you're correct that the -- the percentage of premium method is definitely simple. It will produce consistent outcomes, and it's very easy to apply. Out of all the RSR methodologies, it's definitely the most simple, consistent, and easy to apply. However, when it comes to establishing a Rate Stabilization Reserve, I don't necessarily see these -- these features as benefits.

I believe, at a minimum, an appropriate RSR methodology would have the following features:

1) It would include a detailed assessment of the corporation's key risk areas.
2) It would provide the Board with an understanding of the key risks and the potential range of outcomes for these risks.
3) It would explain to the Board and the public why the corporation needs an RSR at a particular level. So in the case of the DCAT this year, equities are the main risk factor.
4) It would appropriately adjust the RSR target for changes in the Corporation's risk level.

> In my opinion, the percentage of premium method does not have any of these features, and these are essentially the main reasons why the Corporation has requested that the Board discontinue using the percentage of premium method for setting the Corporation's RSR targets."
>
> (Transcript pages 249 to 251)

We think these are compelling arguments and urge the PUB members to try to match the purpose of the RSR and the risks faced with the appropriate methodology.

DCAT Chosen as Preferred Methodology

The Corporation has chosen the DCAT as its preferred methodology to calculate the amount of the RSR target. Its main benefits are:

1. Assists Management and the Public Utilities Board in the identification, measurement and mitigation of key risks faced by the Corporation.
2. Creates a 'forward looking' measure of risk (i.e. not a retrospective measure like other tests).
3. Uses company specific assumptions for adverse scenarios, ripple effects and management action, as opposed to prescribed rules that are the same for every company.
4. Produces an opinion that is based on the RSR targets set by the Manitoba Public Utilities Board.
5. Creates a clear linkage between the required RSR and the amount of risk faced by the Corporation.

The Corporation now has prepared the DCAT for three years in house and has achieved a sophistication with this tool that warrants its adoption.

Mr. Johnston spent time in his direct evidence walking the Board members through the pros and cons of each of the methodologies to calculate the RSR. I am not going to repeat that here, but I did want to comment on other methodologies.

Operational Risk Analysis/Value at Risk

The Operational Risk Analysis, this year, yields an indicated RSR of $193-291m. Let's check out what this methodology has yielded over the past few years. In the 2007 GRA, it had a range of $50-80m, in 2010 GRA its range exploded up to $96-241m, and then in this GRA it yields a range of $193-291m. This is hardly the rate stability that Manitobans desire. By contrast the DCAT, since completed internally at MPI, has yielded $180m, $210m, and now $200m. This is the type of stability Manitobans want and the rate setting process can deliver this if the DCAT is adopted by the PUB.

Percentage of Premium Methodology

"The percentage of premium method assumes that the Corporation's overall risk level is directly related to overall annual premium. The method does not attempt to identify, analyze, assess any of the underlying risks of the Corporation. In other words, it is not a risk-based method". Tr 174 Further on this point, Mr. Johnston said that the percentage of premiums approach was easy to calculate, but not easy to understand

> "I don't think anyone has an understanding of why 10 percent or why 20 percent or why the given range that's produced."
>
> In terms of cons, the method assumes that the Corporation's risk level is again a function of its annual premium level. This assumption is false. The Corporation's main risk, as – as noted here, are from changes to assets and liabilities, which are significantly larger than annual premiums.
>
> Assets are currently two point five (2.5) times greater than annual premiums. Claims liabilities are one point eight (1.8) times annual premiums. And these ratios have increased substantially over time as the Corporation has built up its pool of PIPP claimants.
>
> When the percentage of premium method was first used to set the RSR targets the Corporation did not even invest in equities. And this is what we're identifying in the DCAT as the main risk factor.
>
> Finally the – another key point is that the percentage of premium method does not assist management or the Board in the identification, measurement, or mitigation of key risks." (Transcript page 185)

The percentage of premium method currently indicates a 2013/14 RSR range of $81-$162m.

Board counsel elicited a line questioning and answers from Professor Simpson which established that assets and liabilities are growing faster than the premiums, so over time the percentage of premiums approach becomes smaller relative to the risks the RSR is supposed to protect against. This disconnect between the percentage of premiums methodology and the risks of the assets and liabilities is certainly not sustainable, and does not form the basis for an adequate RSR target.

I don't know what to make of Professor Simpson's "power of incumbency" being the major rationale for sticking to the percentage of premiums approach. I was not convinced and I don't think the PUB should be either.

DCAT Decline in Equities Scenario

The most important adverse scenario identified by the DCAT is the decline in equities.

> "This scenario will test the impact of a 40 percent decline recognized over the next two (2) fiscal years, beginning in '13/14, and '14/15.
>
> The justification for this scenario is that we looked at the cumulative four (4) year returns on the Toronto Stock Exchange, the TSX, from 1919 to present. And based on this data, approximately 5 percent of these four (4) year returns had a loss of negative 43 percent or worse. We use this as justification for the one (1) in twenty (20) year event required by the DCAT. And we selected a 40 percent decline for modeling.

> As recently as February 2009, the TSX experienced a two (2) year total return of negative 40.8 percent. So in other words, we do not have to look far into our history to observe such significant changes.
>
> The Corporation was able to withstand such a significant decline, largely because of the previously noted reductions in claim liabilities at occurred at the – approximately the same time. If it were not for this, the corporation's RSR would have been significantly below the minimum RSR target and would truly have generated a rate surcharge.
>
> As per the table on page 19, you'll see in – at the very last table in '14/15, it indicates that the scenario produces a decline in retained earnings of $200 million relative to the base forecast . And this is essentially the basis of the DCAT recommendation as this is the most adverse scenario." (Transcript pages 235 – 236)

Professor Simpson also testified that the pre 1956 data should be given no weight. Tr 1459 This was notwithstanding Board counsel asking this several times in several different manners. His rationale was that macroeconomic stabilization policy demonstrates that we can now address economic shocks and provided the fact that Presidents Bush and Obama had exercised such policies in the past and that, if elected Mr. Romney, he "suspects" would do the same and listen to his advisors tr 1461. I could argue that given that Mr. Romney has said repeatedly that he will not do so, that is an awfully big assumption Professor Simpson is making and certainly is exactly the type of risk that Mr. Johnston has included in the DCAT in choosing to give some weight to pre 1956 TSX data.

We heard on the day that Professor Simpson last testified in 2008, the TSX experienced a 1100 point drop. In that year 2008/09, the investment income was $4 million – that is $100 million less than budget. But for an actuarial release from the unpaid claims liabilities, the RSR, if it would have been the $81m of the lower range of the percentage of premiums, would have been totally depleted with a net loss of $18m, all other things being equal. A rate increase would have been required in conjunction with an RSR rebuilding surcharge – something that would not have met with much public support from a public that had also experienced investment losses and recession. Do the PUB members really think this is an appropriate way to set rates? This is not something that occurred before 1956, it was just a few years ago, and could happen again soon, especially with uncertainty surrounding some European Union countries' debt levels.

The Chair of the panel asked a very good question – "Why would you expect us to believe that you would sell that position out after a 40 percent drop" in equities? Tr 553. The response was that the DCAT assumed the regular turnover rate of the equity portfolio is about one-third per year, based on internal information. The DCAT also assumed in the first year that, given the significant level of the decline, MPI would also write down about one third of the equity investments. Furthermore, the experience in 2008-09 is that certain equity managers did continue to buy and sell with frequency.

Another question by the Chair was on whether "if you're holding that equity portfolio for extended periods of time, your exposure from equity variations on the stock portfolio is not as dramatic as the DCAT is suggesting"?

> "The first is that in our experience, very, very few equity managers hold anything for any length of time. So, you know, that – the fact that they are turning over the equity portfolios and the accounting rules about having to recognize losses, gains, whatever, when – you know, when – when it is turned over like that negates what you're saying about the fact that we don't really need the equities and – and we're not cashing them in to pay claims.
>
> So the reality of holding that equity, having the equity investments, given the accounting rules, and given the reality that these equity managers are turning it over. And if they sell it for more, we recognize the gain. If they sell it for less, we recognize the loss. It flows right into income. Tr 1287-1288

Sticking with the concept of variability, in slide 2 of Professor Simpson's presentation he shows what is commonly called a 'Bell Curve'. The 'Bell Curve' shows the variability around the mean of a distribution. Using equity returns as an example, the left side of the distribution would provide the range of outcomes below the mean (e.g. a 40% decline for example) and the right side would be the range of outcomes above the mean (e.g. a +40% equity return). We've had a lot of debate about poor equity returns, but how are favourable equity returns used by the Corporation? Don't these 'good' equity years simply offset the 'bad' equity years?

In general, the majority of equity returns from 'good years' are not 'saved' to offset bad years. If the Corporation has an adequate RSR balance, then any additional equity investment income over budget will (in general) be rebated to policyholders, making it unavailable to the Corporation for offsetting future equity losses. So basically, policyholders receive the benefit of favourable returns through rebates, but the Corporation must absorb the impact of unfavourable equity returns through the RSR. In other words, the Bell curve does not work well for the concept of the RSR when MPI simply refunds the equity returns from the right hand side of the Bell Curve.

The exception to these comments, is when the stock market experiences a significant decline, but then subsequently recovers. In this case, the Corporation definitely uses the profits from favourable equity returns to rebuild the RSR and offset the previous equity losses (i.e. it doesn't go to policyholders through rebates). This is one of the key reasons why the Corporation used a 4-year cumulative equity return period in the DCAT. If equity returns do not recover relatively quickly, then the RSR will be depleted and this will likely require a rate surcharge within the first several years.

The Need for a $200m RSR

In the DCAT, the actuarial standards of practice require the actuary to provide an opinion. Mr. Johnston provides his opinion and an explanation to the PUB**:**

> "Most importantly, the opinion in the last paragraph is that the future financial condition of Basic is not satisfactory because there are plausible adverse scenarios that result in reductions to retained earnings that are greater than the Regulator's maximum allowable rate stabilization reserve.
>
> So what I mean here is that as – as we've looked at earlier there's at least a couple scenarios that the reductions that would have – that would occur to RSR is greater than our current RSR target, which is shown as approximately 162 million in 2013/14. And that's on – that's on page 12.
>
> So in this report, I didn't assume that – even though MPI has more than $200 million of retained earnings right now, I didn't feel it appropriate to assume that MPI would continue to have that money, given that the existing RSR maximum is based on percentage of premium method and is 162 million. In prior years, amounts significantly greater than the upper limit would be rebated." (Transcript page 241**)**
>
> "I believe the Corporation and this Board have very strong processes in place that ensure the potential range of results produced by different actuarial judgments in the DCAT is limited.
>
> These processes include:

1) The DCAT report is prepared based on actuarial standards of practice. Therefore, my judgments are confined by accepted actuarial practice.
2) The DCAT report is peer reviewed by our appointed actuary, which provides independent third-party actuarial review.
3) The DCAT report is reviewed and critiqued by the Board, which provides independent third-party review from a regulatory perspective and independent third-party review by actuarial and non-actuarial experts.
4) The key risk -- risk factors in the DCAT are strongly supported by historical data, as we've discussed previously. This should limit significant changes in assumptions.

And, finally, the report is prepared internally, which improves transparency of the process and provides improved understanding for the Board and other interested parties." (Transcript pages 252 – 253)

Though I could highlight a number of points from Professor Simpson's evidence, I only wish to say the Board heard from Professor Simpson much of his praise on the DCAT and some of the problems with the other models. This was elicited during the cross examination by MPI counsel of Professor Simpson. I wish to say, and this might not be apparent to the PUB members since the three of you have been appointed over the past year or more, but there has been considerable convergence, or arriving at consensus, on the DCAT as the tool for calculating the RSR since it was first brought forward to the PUB four years ago.

The S-Word - Solvency

MPI does not use the DCAT as a solvency test. Period. Mr. Johnston takes the actuarial standard DCAT and fits it into MPI's circumstances. In a question to the MPI panel at the end of the hearing on the issue of an adequately funded RSR, the Chair hit the nail on the head when he said, "We'll be hearing from Dr. Simpson in a few days time. And, you know, part of his… submission involves the notion that the monies that are beyond what's required by MPIC, more appropriately belong back in the pockets of Manitobans where they can be spent by Manitobans." Tr. 1265 I can say that since 2001, MPI, under the direction of the PUB, has given the excess monies back to Manitobans in the form of numerous rebate cheques. And that is the beauty of the system of rate setting to a target of an adequately funded RSR.

However, Professor Simpson seems to advocate that the DCAT assessed RSR can be artificially discounted because the Province can simply add monies to the RSR in the event that the RSR is depleted, therefore the RSR need not be adequately funded. That simply is not so. I can't be any more emphatic in stating MPI disagrees with Professor Simpson's assumption wholeheartedly.

Just to give the new panel members some history on previous Board Orders. In Order 122/10 the PUB approved a 10% rebate rather than the 12.9% MPI applied for – and this 2.9% was in excess of the Board target (the PUB said perhaps for a road safety fund). In Order 162/11 the Board was unwilling to order a rebate of the monies in excess of the Board approved target of percentage of premiums written (the PUB said that given the various risk factors faced by MPI and the revisiting of the RSR methodology no rebate would be provided at that time). We don't know whether this seems to be a trend – set a low target RSR, but then not refund monies in excess of that low RSR, because the PUB is uncomfortable with the low level of retained earnings. We very strongly urge the Board to choose a methodology that is intellectually disciplined and transparent. A methodology that will yield an adequate RSR that MPI, intervenors, the Board, and most importantly, ratepayers, can rely upon.

I want to deal straight up with CAC's issue of the Province of Manitoba supposedly insuring MPI's solvency and general financial condition. The PUB should reject this rationale for the following sound reasons:

1. To even enter into such thoughts could be an argument for an RSR of zero;
2. It is not about solvency. period
3. MPI is a crown corporation – owned by, but separate from government;
4. It is about the appropriate level of retained earnings to give Manitobans a semblance of and confidence in rate stability from unexpected and not recurring events;
5. Rate stability is highly valued by Manitobans;

6. The purpose of the RSR is well established for many years, is not under debate, and to throw solvency into this is a red herring;
7. This is about financial security – we know that if we run into negative retained earnings which happened last in the 1990s, that neither the banks nor the Government will shut MPI down; tr 269-270
8. Although somewhat overly simplistic, if MPI has large negative retained earnings, just where is the Government going to get the money from to assist MPI – take monies away from hospitals and schools? Tr 1502

Professor Simpson's Evidence

Professor Simpson's evidence was puzzling to MPI. He approves of the DCAT as being scientific in its approach, evidence based, statistical in its use of data. But then he simply throws the DCAT away in his last two paragraphs on page 20 of his report and advocates an approach that is not scientific, not based on evidence, and does not statistically analyze data. This was absolutely perplexing to MPI and did not follow from his discussion in the previous 20 pages of his evidence. Indeed, it was most disappointing as very little in the previous 20 pages seemed to build up to the final two bullet point recommendations.

As you can tell from Mr. Johnston's rebuttal testimony, MPI was rather horrified that an expert would come to the PUB with a back of the envelope and rough calculation that would decrease the DCAT by $100m. The Corporation does not make $100m decisions based upon “rougher back of envelope” calculations, and neither should the PUB.

The most surprising piece of testimony heard this hearing was from Dr. Simpson, when he provided his candid view of how he views the DCAT was formed.

> “Let me elaborate at this point. Here’s my concern in a very candid fashion. With the Kopstein approach, it’s just rule of thumb. With the RA/VaR approach, you get actual forecasted. You can replicate those numbers; you get an answer. With the DCAT approach, I think the suspicion, until it is eliminated, is that you start out with a number you want to get for the RSR and then you find scenarios that justify that. And that is going to be a concern until that is put to bed. That’s why I said, Not at this time.” Tr 1499

This was not just a slip of the tongue, as Dr Simpson responded again, two questions later,

> “I suggested that the nature of the DCAT analysis, and in particular the choice of scenarios, is that that there are risk with very low probabilities that will generate extremely high RSRs. And until there is consensus on how to resolve the suspicion that the scenario choice is driven by the size of the RSR that you want, that the DCAT remains problematic.” Tr 1500

This even prompted the Chair to ask, twice, if Professor Simpson really believed that the DCAT could be "gamed" to use the terms of the Chair. Tr 1534-1536 The essence of his response was that the use of TSX data was so implausible is that it must be gaming. "I have some concerns about a process that would admit the kind of decline in equities scenario that was proposed in the amended DCAT report." Tr 1539

Although this was surprising for us, so was a comment by CAC counsel at the end of his cross examination of Mr. Johnston. Although muted, it may even have gone unnoticed. Following a response from Mr. Johnston, Mr. Williams stated, "I have no doubt that you could come up with scenarios to justify a $200 million RSR." Tr 1340. CAC's counsel just made the same allegations as did Professor Simpson – namely that the DCAT is a contrived exercise with an end result determined prior to its preparation.

Nothing could be further from the truth. To be true, this astonishing allegation would, in essence, have MPI management directing the Chief Actuary and external Appointed Actuary to sign opinions that could be contrary to their professional standards. Perhaps Professor Simpson did not realize that he was calling into question the professional integrity of the Chief Actuary and of the Appointed Actuary, but also extended to the Actuarial profession, and, likely even extended to other professions such as chartered accountants who sign audit opinions and lawyers who sign legal opinions on corporate transactions.

We will have to trust the PUB on acknowledging the integrity of MPI Management on not interfering with the DCAT process, the independence the Chief Actuary has in preparing the DCAT, and the independence of the Appointed Actuary in the peer review. For the Chief Actuary, Mr. Johnston, this was his first time ever testifying; he testified in a credible and open manner on the DCAT and the gravitas of his testimony should be taken into account and weighed by the PUB.

Professor Simpson and the Decline in Equities Scenario

In his rebuttal evidence, Mr. Johnston identified a number of critical faults with the Simpson approach. Professor Simpson, who admitted never preparing a DCAT calculation, provides a slide that suggests that the estimated impact from a 4 year equity decline of 20% is $100M. The Corporation would forego $108m of equity investment income in this four year period, relative to budget. You'll note that this figure is already greater than the $100M presented from Professor Simpson. A 20% decline on the equity assets would be a further $75m decline in the investment portfolio.

A full DCAT review of this scenario would of course include the consideration of management and regulatory action. There were no assumptions presented by Professor Simpson in this regard. These assumptions are obviously very important in terms of how the Board responds to a $183M loss. MPI would strongly recommend that the Board does not consider 'rougher, back of envelope' calculations for determining the appropriate RSR target.

In regards to the significant decline in equity returns that occurred in 2008/09 and after, Professor Simpson said "over time, and it – it rebuilt pretty fast once stocks recovered; at least my pension fund did". Have MPI's equity recovered since 2008/09?

As per the Corporation's response to undertaking 16 and 17, page 2, the Corporation's equity investment income has been $150M under budget in total over the last 4 years, including $33.6M under budget in 2011/12. This is not what I would call a recovery. Again, as previously mentioned, unlike Professor Simpson the Corporation does not get to keep the equity returns from 'the good years' to offset the 'bad years'. Excess equity returns are rebated to policyholders to the extent that the Corporation is significantly above the Board's RSR target.

Peer Review of DCAT

The peer review of the DCAT was filed as Ex 31. As the external appointed actuary, Mr. Cheng opined:

1. The work of the Chief Actuary is within the range of accepted actuarial standards of practice in Canada.
2. The assumptions and methods employed are appropriate. Etc.

This peer review is what both Mr. Pelly, the Board actuarial advisor, and Ms. Sherry, CAC's actuarial advisor, are familiar with. The external appointed actuary occupies a position that is somewhat analogous to an independent auditor in writing their opinion on the soundness of financial statements. We urge the PUB to take great comfort in the fact that two actuaries have issued their professional opinions on the DCAT.

CAC's Missing Actuary

Another perplexing aspect was the choice of CAC to bring forward Professor Simpson to file evidence and testify. Given that CAC now has retained an advisor that is an actuary who actually prepares DCATs and is familiar with actuarial concepts of risks for insurers, perhaps Ms. Sherry could have been a better choice. We don't know why the CAC actuary was not chosen to testify. We don't know if she, like other actuaries, uses TSX data back to 1919, and we don't know if she agreed with Professor Simpson's ", "rougher, back of the envelope" tr 1436 suggested $100m DCAT. Tr 1470-1475

Instead, CAC produced an economist to provide an economic analysis of an actuarial review – not all that helpful for the corporation or, indeed, the Board. It does, however, help with Mr Williams' lobbying for more process, greater discussion, and multi disciplines. This lends itself to a number of questions, none of which can be answered:

- Does the CAC actuary use TSX data from 1919 in the preparation of her own DCAT?
- Does the CAC actuary approve of the assumptions and methodology in the DCAT prepared by MPI that yields $200m?
- Does the CAC actuary support the $100m DCAT of Professor Simpson?

$200M DCAT/ESCROW ACCOUNT

Though CAC did not agree with implementing the DCAT now, its witness, Professor Simpson, advocated both a $100m DCAT and $100m RSR, yet CAC recommends an RSR upper limit of $150m. However, CAC then paused and recommended the PUB not issue a rebate even though there is $210m in the RSR now! CAC spent an awful lot of time trying to get the DCAT down to a low number, but then doubles the indicated amount for the RSR in the end anyways. MPI is pleased that CAC agreed, in its own fashion, that the RSR should be at a minimum of $200m and thanks CAC for that endorsement.

This position of CAC raises a number of issues and questions:

- Why try to drive the DCAT down to $100m, but then set the minimum RSR at 150% of the DCAT?
- Why have the DCAT at $100m, minimum RSR at $150m, but then set the rebate threshold at a minimum of $200m?
- Why set the rebate threshold at more than 200% of the DCAT?
- Has CAC abandoned support for its own witness who advocated a $100m RSR and $100m DCAT?

What this comes down to is that an enormous amount of money, time, and effort was consumed to argue the plausibility of the decline in equities scenario and the data utilized therein. But, at the end of the day, CAC is not anywhere near to comfortable with a $100m RSR. MPI is not comfortable, to say that least, with a $100m RSR either. Mr. Johnston's table in the rebuttal evidence showed just how hard and long it takes to rebuild the RSR if there is a major decline in equities. Mr. Johnston also used, for illustrative purposes only, a 15.6% one year surcharge, followed by a second 7.25% surcharge. A surcharge of such a magnitude, is, of course, unlikely, but if it were a smaller amount of say 4%, then if the 4% surcharge yielded approximately $30m, then it will take several years to rebuild the RSR and hopefully MPI does not suffer any other adverse events, or there are no concurrent rate increases.

Based on some of the questions asked by Mr. Gosselin there may be a notion that the Basic RSR could be inadequately funded, because other lines of business could simply transfer monies over. I strongly encourage the Board members to re-read Ms McLaren's response to the Chair at pages 1581-1585 of the transcript where she provided a number of very compelling reasons that the Board ought not to take that approach.

RSR and DCAT Conclusion

Ultimately, in the quest for the methodology for determining an adequately funded RSR, the PUB should believe in the DCAT. It is reflective of the risks faced by MPI, which is what the intended purpose of the RSR is, and it is a clearly documented process which adheres to professional standards and methodology that is both peer reviewed by the appointed Actuary and reviewed in detail at these hearings, including by the PUB's actuarial advisor, amongst other benefits. At the end of the day, the PUB should buy into the DCAT to determine an adequately funded RSR. The PUB should not, as the PUB has done in previous years, determine an RSR target, but then be unwilling to set rates based on that RSR target.

So, in summary, the Corporation recommends that the DCAT be adopted as the method to calculate the required RSR. The DCAT explicitly measures the potential financial impact from the Corporation's key risk factors and produces a RSR target that is directly related to the Corporation's risk level and directly responsive to the purpose of the RSR. In other words, it is the only method that truly identifies the risks faced by MPI and produces a target that is directly related to the purpose of the RSR. Tr 256
MPI has also indicated it is willing to be more consensus based in preparing the DCAT and can commence the DCAT process earlier.

One final item is that MPI asks the PUB to support the DCAT as the sole methodology to calculate the RSR target and that the other methods (Percentage of Premiums, , and Risk Analysis) need not be prepared in the future.

RSR Minimum of $200M Required

The record clearly indicates that, in response to a question from the Chair at the end of the hearing, retained earnings need to be **in excess of $200m** to Mr. Johnston to state in his opinion the corporation is in a satisfactory financial condition. Tr 1258

Finally, Ms McLaren provided some advice for the Board with respect to a range around the $200m ought to be established.

> "I think it's -- it's my job to make the point that according to actuarial standards the minimum target really does need to be $200 million according to the DCAT that's in front of this Board right now.
>
> So for example, if the Board chose to have a range around two hundred (200), of one seventy (170) to two-thirty (230), something like that, when we're sitting around one-seventy (170), one-eighty (180), that would not meet the actuarial test of satisfactory financial condition because it would be significantly under the -- the 200 million.
>
> My -- my advice is really that the Board would stay away from a range. The target is based on a methodology that produces a number as opposed to a range, and I think it's really important that – that we all understand that, you know, things evolve, things change, and -- and what is the target for? What would it range before? The target is really to give this Board a sense as to when it would pull the trigger on rebates and, alternatively, when it would pull the trigger to order surcharges on top of basic Autopac premiums to re-build an RSR." (Transcript pages 258 – 259)

DSR

MPI is also proposing that driver premiums for DSR demerit levels 1 to 20 will increase to a maximum of $2500 for 2013/14. The change is the third year of the three year phased in increases to driver premiums for the DSR demerit levels, which was originally presented to the PUB in April 2009. This is the final stage of the multi-year plan to transition to DSR and the PUB has been an instrumental partner with MPI and the Government in setting up this important new system to rate drivers and encourage and reward financially good driving behaviour.

As noted in MPI Exhibit # 17, should a driver at -20 in 2012 who pays $2000 have one clean year of driving, then in 2013 that same driver would pay $1100 for their next dirvers licence in 2013, as proposed. That driver would not go from $2000 to $2500 unless they had further infractions in 2012 driving year. The evidence is clear that the driver has been provided with notice of DSR movement since the introduction of DSR three years ago, which is updated annually at the time of the renewal of the drivers licence, and that clean driving clearly is reflected in quick positive movement up the DSR scale.

MOTORCYCLE RATES

CMMG argued that motorcycle rates are still not fair and just and over the past decade have had higher rate increases than other vehicles. What CMMG did not say was that motorcyclists received the same rebate cheques as other ratepayers due to the conservatism in the forecast. The rebated amounts were not included in the premiums collected as set out in CMMG 2-8. Motorcycle rates are set by a rolling ten years of claims experience to allow for smoothing due to the relatively small pool with a number of large losses.

CMMG's counsel recommended at 5% decrease in motorcycle rates. However, there was no exploration of the extensive information in the application including the rate setting calculations for motorcycles. This material is in the application and was not reviewed before the Board. MPI submits there is no merit in a 5% decrease at this time. In the event that motorcycle claims incurred decreases, it will be reflected in decreased rates, subject to the rolling ten years of data.

FLAT PIPP RATE

CMMG brought forward a new argument this year calling for a flat PIPP rate to be attached to the drivers licence, and not to the vehicle. I think Ms. McLaren provided a really fine response listing how this fundamentally changes the insurance scheme within Manitoba and should not be adopted. Similar to CAC, I will point to the transcript of this response and urge the Board to review those pages. Tr 1231-34

CONCLUSION

First, the corporation submits the indicated no overall change in rates should be approved. No evidence was adduced to suggest anything but this is appropriate.

Second, MPI submits the PUB should approve the final step in the DSR implementation by increasing DSR level -1 to -20 to a maximum of $2500. This is outlined in AP.1.

Third, MPI submits the new cost allocation methodology should be approved for rate making purposes.

Fourth, the Corporation submits the PUB should adopt the DCAT methodology to determine the Basic Autopac RSR target, and for 2013/14, set a an RSR target of $200m.

There is no evidence that the intervenors suggested rate decreases are appropriate, actuarially sound or sustainable, or based on anything tangible.

In closing, MPI submits that it has satisfied the onus that its rates as applied for are just and reasonable and requests the PUB approve them. The Corporation has placed sufficient evidence on the record for the PUB to approve the rates as applied for. As usual, the Corporation requires an Order on or about December 1, 2012.