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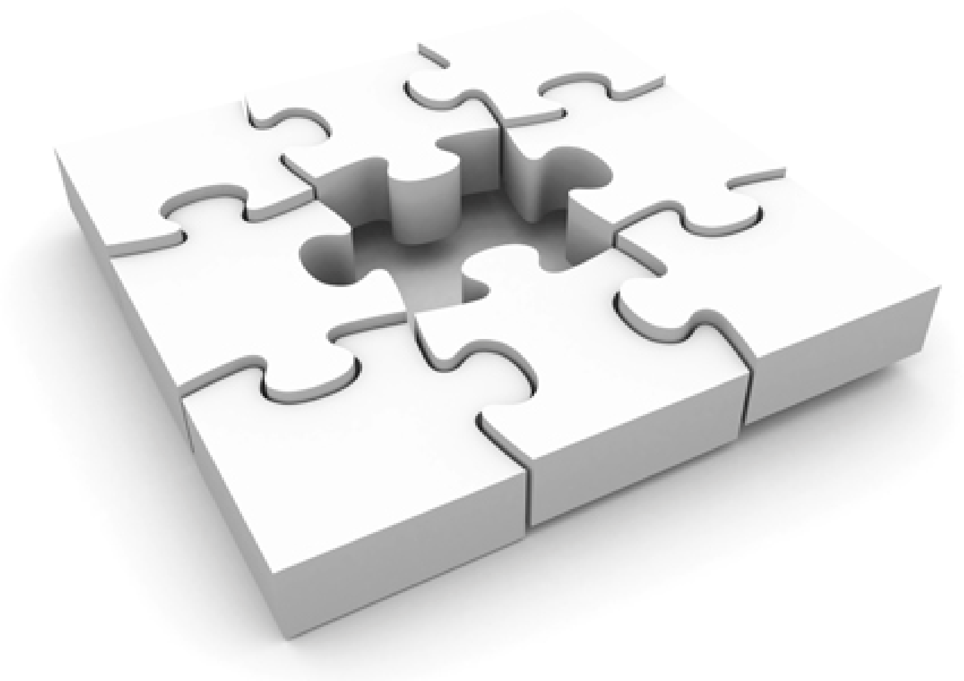
Manitoba Public Insurance

Impact of IAS 19R



May 15, 2012

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1.0 Executive summary

Background

IAS 19R, the standard governing accounting for Employee Future Benefits under IFRS, is effective for periods beginning on or after January 1, 2013, with early adoption permitted. Manitoba Public Insurance ("MPI") is considering early adopting this standard for the period beginning March 1, 2012.

MPI is less affected by the change in these employee benefit standards than most other organizations; due to the fact MPI does not segregate its pension-related investment assets to fund the plan.

The most significant impacts of the new standards are:

- how the components of the annual pension expense flow through the financial statements; and
- the extent of disclosure that will be required in the financial statements.

Components of pension expense

Impact on annual financial results

The components of annual pension cost are recorded in the annual financial results and reflected differently under the new standard as shown below.

Component of annual pension cost	New IAS 19	MPI's application of Old IAS 19*
Current service cost	Profit and loss (statement of operations)	Profit and loss (statement of operations)
Interest cost	Profit and loss (statement of operations)	Profit and loss (statement of operations)
Actuarial gains/losses (also known as remeasurement gains/losses)	Other comprehensive income (OCI)*	Profit and loss (statement of operations)

*Based on MPI's current IAS 19 policy

Presentation within equity

The components on MPI's aggregate/accumulated pension cost to date will also be reflected differently under the new standards beginning March 1, 2012 (presuming early adoption is approved). This difference is set out below

Component of accumulated pension cost	New IAS 19	Old IAS 19*
Current service cost and interest cost incurred to February 28, 2011	Retained earnings	Retained earnings
Current service cost and interest cost incurred after March 1, 2011	Retained earnings	Retained earnings

Component of accumulated pension cost	New IAS 19	Old IAS 19*
Actuarial gains/losses for both 2011/12 and 2012/13 (also known as remeasurement gains/losses)	A separate component of equity that is not retained earnings. We suggest a separate component within Accumulated Other Comprehensive Income (AOCI)**	Retained earnings

** the new standard permits the reclassification of remeasurement gains and losses within equity, after their recognition as part of OCI in the determination of the annual results. This presents MPI with a choice. The accumulated actuarial gains/losses could continue to be reclassified to retained earnings; or they could be identified as a separate component of equity within AOCI. Based on MPI's desire to segregate the impact of actuarial gains/losses, we are recommending the latter option.

Transition restatements (required at March 1, 2011 the start of the comparative year)

Comparative year statement of changes in equity	A separate column to reflect the re-measurement gains/losses as a separate component of equity for the 2011/12 year will be required.
	Actuarial gains and losses to March 1, 2011 will remain in retained earnings; no restatement for accumulated remeasurement losses to that date is required
Comparative year statement of operations	Q1 to Q3 Quarterly impact – no impact anticipated, as actuarial gains and losses are calculated and recorded once per year, typically in the 4th quarter.
	Actuarial gains/ losses for the comparative year will be presented in OCI within the statement of comprehensive income (and not in the statement of operations as done previously)
Current year statement of changes in equity	A separate column to reflect the remeasurement gains/losses as a separate component of equity should be presented.
Current year statement of operations	Q1 to Q3 Quarterly impact – no impact anticipated, as actuarial gains and losses are calculated and recorded once per year, typically in the 4th quarter.
	Actuarial gains/ losses for the current year will be presented in OCI within the statement of comprehensive income (and not in the statement of operations as done previously)
Current year note disclosure	Disclosure of the adoption of the new standard in the notes to the financial statements is required. New disclosure requirements, as noted below, must be adhered to.

Disclosure

The following are key additional disclosures required by the revised standard:

- Additional disclosure related to the risks specific to the plan
- Additional sensitivity disclosures related to the impact of changes in key assumptions and their impact. Comparative year disclosures are not required.
- Additional disclosure of future cash flow expectations and commitments

Other factors

Other amendments to IAS 19	Possible impact
Definition of short–term employee benefits	The amendments may impact the measurement of certain benefits previously categorized as short–term in nature.
Mortality rates	Under the new standard, the mortality rates to be used should take into consideration expected changes to those tables. This may impact the measurement of the defined benefit obligation.

Other matters to consider

As a result of an educational note published by the Canadian Institute of Actuaries in 2011, there has been increased focus on the determination of the discount rate used for defined benefit plans. This matter should be discussed with your actuaries.

Summary

There will be no impact on equity to February 28, 2011, as actuarial gains and losses accumulated to this date, will remain in retained earnings as previously presented. The actuarial gains and losses accumulated from March 1, 2011 forward will be presented separately in equity within the financial statements. The adoption of this standard will have limited impact on MPI's reported aggregate financial position and results. The principal difference for MPI under the new standard arises from the segregation of the impact of actuarial gains and losses to OCI in the determination of annual results, and their accumulation in AOCI in the presentation of financial position. To the extent that this segregation is a material factor for any given user of MPI's financial statements, the adoption of the new standards may impact how such users view MPI's financial situation.

2.0 Analysis of significant differences in IAS 19R

2.1 Recognition

Actuarial gains and losses		
IAS 19	**Amendments in IAS 19R**	**Impact**
Currently an entity may choose to recognise actuarial gains and losses in profit or loss immediately or through the use of the corridor approach. They also can recognize the gains and losses immediately in other comprehensive income ("OCI"); when recognized in OCI these actuarial gains and losses shall be immediately moved into retained earnings and shall not be reclassified to profit or loss in a subsequent period. (IAS 19.7, 93D)	The amended standard removes the option of recognising actuarial gains and losses in profit or loss as well as the corridor approach. Any re-measurements recognised in other comprehensive income shall not be reclassified to profit or loss; however those amounts recognised in other comprehensive income may be transferred within equity. (IAS 19R.1, IAS 1R.120,122)	This amendment will have a significant impact on MPI as currently actuarial gains and losses are recognized in profit or loss. Under the new standard these gains and losses run through other comprehensive income. The change will also allow MPI to present actuarial gains and losses separately in equity. A further discussion on this impact can be found in section 3.0.
Past service costs		
IAS 19	**Amendments in IAS 19R**	**Impact**
Under the current standard past service costs are recognized as an expense and amortised on a straight-line basis over the period until the benefits become vested. Any vested past service costs are currently recognized immediately. (IAS 19.96)	Past service cost are to be recognised as an expense at the earlier of the following dates: i. When the plan amendment or curtailment occurs ii. When the entity recognises related restructuring costs or termination benefits (IAS 19R.103)	The difference will have no transitional impact on MPI given that there are no unamortized past service costs in any of the plans.

<table>
<tr><th colspan="3">Curtailments</th></tr>
<tr><th>IAS 19</th><th>Amendments in IAS 19R</th><th>Impact</th></tr>
<tr><td>A curtailment occurs under the current IAS 19 when an entity either:
i. Is demonstrably committed to make a significant reduction in the number of employees covered by a plan; or
ii. Amends the terms of a defined benefit plan so that a significant element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.
These curtailments are recognised when they occur.
(IAS 19.109, 111)</td><td>A curtailment occurs when an entity significantly reduces the number of employees covered by a plan. A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan. A curtailment is considered to be a change in past service cost and is therefore recognized:
i. When the plan amendment or curtailment occurs
ii. When the entity recognises related restructuring costs or termination benefits
(IAS 19R. 103, 105)</td><td>Under the amended standard a curtailment is recognized when it occurs; replacing the current standard of recognizing them when the entity is demonstrably committed; this may result in later recognition under the amended standard.
The second difference is when a curtailment is linked with a restructuring. Under the current standard these are recognized together; under the amended standard they are recognized together if the restructuring happens first. If the curtailment occurs previous to the restructuring they are not linked and the curtailment must be recognized when it occurs.
There will be no transitional impact on MPI.</td></tr>
<tr><th colspan="3">Settlements</th></tr>
<tr><th>IAS 19</th><th>Amendments in IAS 19R</th><th>Impact</th></tr>
<tr><td>A settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for a part or all of the benefits provided under a defined benefit plan. (IAS 19.112)</td><td>The definition of a settlement under the amended IAS 19 remains fairly similar to the current standard in that a settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan. However if the payment of benefits is to, or on behalf of, employees in accordance with the terms of the plan and included in the actuarial assumptions. In this case it will be considered a re-measurement and will be included in actuarial gains and losses in OCI.
(IAS 19R.8, 76, 111)</td><td>The main impact is that the distinguishing of settlements and re-measurements may cause the recognition to either be recognized in other comprehensive income (if a re-measurement) or in profit or loss if it meets the definition of a settlement.
There will be no transitional impact to MPI.</td></tr>
</table>

2.2 Measurement

Taxes payable		
IAS 19	**Amendments in IAS 19R**	**Impact**
All taxes payable by the plan are included in the calculation of the return on plan assets. (IAS 19.7)	The amended standard removes a portion of the taxes payable from the calculation of return on plan assets. The portion of taxes payable that is removed is the tax that is included in the actuarial assumptions used to measure the present value of the defined benefit obligation; which consist of taxes payable on contributions or benefits. (IAS 19R.76, BC124)	Since MPI holds no assets related to the defined benefit plan, this will have no transitional impact on MPI.
Actuarial assumptions		
Administration costs		
IAS 19	**Amendments in IAS 19R**	**Impact**
Administration costs currently reduce the return on plan assets other than those included in the actuarial assumptions used to measure the defined benefit obligation. (IAS 19.7)	The amended standard changes the way in which administration costs are measured. Only costs related to managing plan assets are used to reduce the return on plan assets. Other administration costs are not to be deducted from the return on plan assets; these costs are also to be recognized when the services are provided and therefore cannot be included in the actuarial assumptions and including them in the measurement of the defined benefit obligation is no longer allowed. (IAS 19R.76, 127, 130)	Since MPI holds no assets related to the defined benefit plan, this will have no transitional impact on MPI.
Income taxes		
IAS 19	**Amendments in IAS 19R**	**Impact**
All taxes payable by the plan are included in the calculation of the return on plan assets. (IAS 19.7)	The amended standard removes a portion of the taxes payable from the calculation of return on plan assets. The portion of taxes payable that is removed is the tax that is included in the actuarial assumptions used to measure the present value of the defined benefit obligation; which consist of taxes payable on contributions or benefits. (IAS 19R.76, BC124)	Since MPI holds no assets related to the defined benefit plan, this will have no transitional impact on MPI.

Actuarial assumptions		
Expected mortality rates		
IAS 19	**Amendments in IAS 19R**	**Impact**
The current standard acknowledges mortality rates that are used in the actuarial assumptions. It states that these assumptions are an entity's best estimate that will determine the ultimate cost of providing post-employment benefits. (IAS 19.73)	The current standard explicitly states that mortality rates will reflect current estimates of the expected employee mortality rates. It also specifically states that this includes modifying standard mortality tables to reflect estimates of mortality improvement anticipated to occur after the reporting date. (IAS 19R.81, 82)	The explicit requirements in the amended standard cause more attention to be brought to the mortality tables being used by the actuary when making the assumptions and to ensure that the actuary is using mortality rates that are relevant to MPI.
Risk sharing		
IAS 19	**Amendments in IAS 19R**	**Impact**
The current standard does not have specific guidance on how to deal with the following risk sharing situations: i) risk sharing between the employer and the employee or other third party; or ii) the effect of performance targets or other criteria.	The amended standard both of these issues are taken into consideration. The amended standard distinguishes between discretionary contributions and contributions that are set out in the terms of the plan. - Discretionary contributions by employees or third parties reduce service cost upon payment of the contribution to the plan. - Contributions from employees' or third parties that are set out in the formal terms of the plan either reduce service costs (if they are linked to service), or reduce remeasurements of the net defined benefit liability (asset). Contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit. (IAS 19R.87, 92-94) The amended standard requires that actuarial assumptions reflect future benefit changes that are set out in the formal terms of a plan at the end of the reporting period. This includes if benefits vary in response to a performance target or other criteria. The measurement of the obligation reflects the best estimate of the effect of the performance target or other criteria. An example of a situation where this would occur is if a plan states that reduced benefits will be paid or additional contributions from employees' must be paid if plan assets are insufficient. (IAS 19R.88(c))	Since the current standard does not give specific guidance on the treatment employee and third party contributions the current treatment may not be in accordance with the amended standard. The new guidance will result in these contributions being recognized when they occur and will have to be incorporated into the valuation of the defined benefit obligation.

Service costs		
IAS 19	**Amendments in IAS 19R**	**Impact**
Service costs under the current standard are recognised in profit or loss.	The presentation of service costs does not change in the amended standard however the amount of service costs will be affected by other amendments including the following: – Taxes payable on contributions and benefits for service during the period – Changes in administration cost recognition – Include full recognition of past service costs including re-measurements or curtailments	Since MPI does not have any unamortized past service costs, taxes are not applicable and there is no impact on the changes to administration costs this amendment will not have a transitional impact on MPI.

Net interest		
IAS 19	**Amendments in IAS 19R**	**Impact**
Currently under IAS 19 interest costs are recognized in profit or loss and are calculated by taking the discount at the start of the period by the present value of the defined benefit obligation throughout the period. The current standard also includes the expected return on plan assets in the net interest number that goes into profit or loss. This number is calculated by taking the expected rate of return over the life of the obligation and multiplying it by the fair value of plan assets through-out the period. (IAS 19.61,82)	The presentation of finance costs did not change in the amended IAS 19 in that they will still be recognized in profit or loss. The main change in regards to finance costs is the way that they are calculated. The net interest will now be calculated on a net defined benefit liability (asset) basis using the same discount rate. This net interest number includes the following: – Interest costs on the defined benefit liability – Interest income on plan assets – Interest on the effect of the asset ceiling (IAS19R.8,123-125)	The main impact of this amendment is that the expected return on plan assets used currently under IAS 19 will no longer be used under the amended IAS 19; instead the plan assets multiplied by the discount rate will be used. MPI does not have segregated investment assets to fund their defined benefit plans, therefore, this amendment will not have a significant impact on MPI.

2.3 Termination benefits

Recognition		
IAS 19	**Amendments in IAS 19R**	**Impact**
Termination benefits are recognised when the entity is demonstrably committed to either terminate the employment of an employee or group of employees before the normal retirement date or provide termination benefits as a result in order to encourage voluntary redundancy. (IAS 19.133)	Under the amended standard an entity recognises a liability and an expense for termination benefits at the earlier of the following dates: – When it recognises costs for a restructuring within the scope of IAS 37 that includes the payment of termination benefits – When it can no longer withdraw the offer of those benefits (IAS 19R.165-167)	MPI does provide termination benefits and therefore further analysis will have to be performed on any termination benefits to determine if they have been properly recognised under IAS 19R.

Measurement		
IAS 19	**Amendments in IAS 19R**	**Impact**
Where termination benefits fall due more than 12 months after the end of the reporting period they shall be discounted using a rate that is of a high-quality corporate bond.	Under the amended standard termination benefits are measured upon initial recognition and subsequent changes are measure and recognised in accordance with the nature of the employee benefit. The three categories that subsequent changes to termination benefits can qualify as are as follows: i. If the termination benefits are provided as an enhancement to a post-employment benefit plan, then an entity applies the requirements for post-employment benefits ii. If the termination benefits are expected to be settled wholly before 12 months after the end of the annual reporting period in which the termination benefit is recognised, then an entity applies the requirements for short-term employee benefits iii. If the termination benefits are not expected to be settled wholly before 12 months after the end of the annual reporting period, then an entity applies the requirements for other long-term employee benefits. (IAS 19R.169)	MPI will have to assess the termination benefits that it currently has in order to determine which criteria will apply; this may or may not have a significant impact on the measurement of the termination benefits, depending on the timing of expected benefit payments.

2.4 Discussion of state plan

IAS 19	Amendments in IAS 19R	Impact
Under the current IAS 19 State plans are established by legislation to cover all entities and are operated by national or local government or by another body which is not subject to control or influence by the reporting entity. Some plans established by an entity provide both compulsory benefits which substitute for benefits that would otherwise be covered under a state plan and additional voluntary benefits. Such plans are not state plans. [IAS 19.37]	Under the amended IAS 19R there is no change to the definition of a state plan. There is also no change to the guidance that an entity shall account for a state plan in the same way as for a multi-employer plan. [IAS 19.43-45]	Since the definition and guidance for accounting for state plans did not change in the amended standard, MPI's plans administered by the Civil Service Superannuation Board are post-employment benefit plans. Also with respect to the portion of the plan that does not relate to employee contributions, MPI does have a legal or constructive obligation to pay the future benefits that it is responsible for. This portion of the plan is a defined benefit plan.

2.5 Short-term employee benefits

IAS 19	Amendments in IAS 19R	Impact
Under the current standard *short-term employee benefits* are employee benefits (other than termination benefits) that are due within 12 months after the end of the period in which the employees render the related service. [IAS 19.7]	Under the amended standard *short-term employee benefits* are employee benefits (other than termination benefits) that are **expected** to be settled **wholly** before twelve months after the end of the **annual reporting** period in which the employees render related services An entity will not need to reclassify short-term employee benefits to other long-term employee benefits if the entities expectation of the timing of settlement is temporary. [IAS 19R.8, 10]	The impact of the change in the definition of *short-term employee benefits* will add increased judgement from management as the word "expected" is now included. Also the timeline is clarified to ensure consistency in the definition. MPI will have to review the classifications of their employee benefits on an ongoing basis.

2.6 Disclosures

The amended standard changes the requirements of defined benefit plans, many of the required disclosures remain the same or have slight changes, however there has also been some significant changes or new requirements under IAS 19R. This portion of the memo will outline the significantly changed or new disclosure requirements and will also highlight any disclosure requirements that have been removed.

IAS 19R.135 outlines three objectives that the disclosure requirements are trying to meet under IAS 19R. These objectives are as follows:

- Explains the characteristics of the plan and risks associated with them
- Identifies and explains the amounts in its financial statements arising from its defined benefit plans
- Describes how its defined benefit plans may affect the amount, timing and uncertainty of the entities future cash flows

The following table will discuss the disclosures organized into the three objectives discussed above.

Characteristics of the plan and risks associated with them	
Disclosure requirement	**Impact**
Information about the characteristics of its defined benefit plans including: i. The nature of the benefits provided by the plan ii. A description of the regulatory framework in which the plan operates, for example the level of any minimum funding requirements, and any effect of the regulatory framework on the plan, such as the asset ceiling iii. A description of any other entity's responsibilities for the governance of the plan, for example responsibilities of trustees or board members of the plan [IAS 19R.139(a)]	• MPI previously discloses this information therefore there will be no transitional impact. • MPI will be required to incorporate this new disclosure. • MPI currently discloses that the plan is administered by CSSB.
A description of the risks to which the plan exposes the entity, focused on any unusual, entity-specific or plan specific risks, and of any significant concentration of risks. [IAS 19R.139(b)]	• MPI will be required to incorporate this new disclosure.
A description of plan amendments, curtailments and settlements. [IAS 19R.139(c)]	• MPI will be required to incorporate these new disclosures if the circumstances arise.

Identifies and explains the amounts in its financial statement arising from the plan	
Disclosure requirement	**Impact**
Provide a reconciliation from the opening balance to the closing balance for each of the following: – The net defined benefit liability(asset), showing separate reconciliations for: i. Plan assets ii. Present value of the defined benefit obligation iii. Effect of asset ceiling – Any reimbursement rights including a description of the relationship between any reimbursement right and the related obligation [IAS 19R.140]	• MPI previously discloses this information therefore there will be no transitional impact. • This disclosure was also required under the previous IAS 19.120A(f), therefore there will be no transitional impact.

Identifies and explains the amounts in its financial statement arising from the plan	
Disclosure requirement	**Impact**
For the above reconciliations each of the following should be shown: – Current service costs – Interest income or expense – Re-measurements of the net defined benefit liability(asset) showing the following separately: i. Return on plan assets ii. Actuarial gains and losses resulting from demographic assumption changes iii. Actuarial gains and losses arising from changes in financial assumptions iv. The effect of the asset ceiling limit on a defined benefit asset – Past service cost and gains and losses arising from settlements – Effect of changes in foreign currency exchange rates – Contributions, showing separately employee and employer contributions – Payments from the plan – The effect of business combinations and disposals [IAS 19R.141]	• MPI previously discloses this information therefore there will be no transitional impact.
Numerical disclosure disaggregating the fair value of the plan assets into classes that distinguish the nature and risk of those assets, subdividing each class of plan asset into those that have a quoted market price in an active market and those that do not. [IAS 19R.142]	Not applicable to MPI as MPI does not have assets, specifically, segregated investment assets to fund their defined benefit plans.
The fair value of the entity's own transferable financial instruments that are held as plan assets and fair value of plan assets used by the entity [IAS 19R.143]	Not applicable to MPI as MPI does not have assets, specifically, segregated investment assets to fund their defined benefit plans.
The significant actuarial assumptions used to determine the defined benefit obligation. [IAS 19R.144]	This disclosure requirement remains unchanged from the previous IAS 19 and therefore should not have an impact on MPI as the disclosure will remain the same as before adoption.

Describes how its defined benefit plans may affect the amount, timing and uncertainty of the entities future cash flows	
Disclosure Requirement	**Impact**
A sensitivity analysis that shows the effect of each significant actuarial assumption that is within reason at the beginning of the reporting period. The methods and assumptions used in determining the sensitivity analysis should also be disclosed and the limitations of those methods. Finally any changes from the previous period in assumptions and methods shall also be disclosed. [IAS 19R.145]	The sensitivity analysis will need to be prepared by MPI under the amended IAS 19, however there is an exception in the retrospective application required by IAS 8 – *Accounting, policies, changes in accounting estimates and errors* in that financial statements beginning before January 1, 2014 do not need to present comparative information in regards to the sensitivity analysis disclosure. [IAS 19R.173(b), BC269(b)]
The disclosure of any asset-liability matching strategies used by the plan. [IAS 19R.146]	Not applicable to MPI as MPI does not have assets, specifically, segregated investment assets to fund their defined benefit plans.
In order to provide an indication of the effect of the defined benefit plan on the entities future cash flows the following disclosures are required: – A narrative description of any funding arrangements and funding policy that affect future contributions – The expected contributions to the plan for the next annual reporting period – Information about the maturity profile of the defined benefit obligation. [IAS 19R.147]	MPI will be required to incorporate this new disclosure, this includes a disclosure of the fact that the asset side of the plan is accounted for as a defined contribution plan as MPI has no legal or constructive obligation to pay any future benefits, this obligation rests with the Civil Service Superannuation Board.

3.0 Analysis of recognition of actuarial gains and losses

The amended standard requires that re-measurements are recognised immediately in other comprehensive income and are not reclassified subsequently to profit or loss. MPI has three different options in regards to meeting the requirements of this standard as it is currently recognising actuarial gains and losses in profit and loss. MPI will have the following three alternatives when presenting for the re-measurements of the defined benefit obligation:

Presentation option	Implications
Recognise immediately in other comprehensive income and presented within retained earnings which is similar treatment to the IAS 19 existing requirements when the OCI option is chosen.	The main benefit of this framework choice is that it would be the most simple in regards to transition adjustments. However it will not allow for the desired expectation of having the accumulated actuarial gains and losses presented separately accumulated other comprehensive income.
Recognise immediately in other comprehensive income and transfer the balance into accumulated other comprehensive income with the disclosure that the accumulated balance contains re-measurements from the initiation of the plan.	The implication of this presentation option is that the all accumulated actuarial gains and losses will be presented separately in accumulated other comprehensive income would require the accumulation of all pre-transition actuarial gains and losses.
Recognise immediately in other comprehensive income and transfer the balance going forward (from March 1, 2011) into accumulated other comprehensive income disclosing that the balance contains accumulated re-measurements starting from March 1, 2011 and that previous accumulated gains and losses are included in retained earnings.	The wording in IAS 19R.122 states that an entity **may** transfer those amounts recognised in other comprehensive income within equity. This allows for the accumulation of re-measurements for the years presented in the financial statements. A disclosure stating that the balance in accumulated other comprehensive income is two years of re-measurements will be required. The benefit of this option is that it meets MPI's desired presentation for measuring actuarial gains and losses in accumulated other comprehensive income, without the effort required to accumulate all pre-transitional actuarial gains and losses.

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September 9, 2013

Ms. Heather Reichert, FCA
Vice President, Finance & Chief Financial Officer
Manitoba Public Insurance
929-324 Donald Street
Winnipeg, MB R3C 4A4

Re.: Update to the IAS 19R impact assessment paper prepared May 15, 2012

Dear Heather,

Background:
IAS 19R, the standard governing accounting for Employee Future Benefits under IFRS, is effective for periods beginning on or after January 1, 2013, with early adoption permitted. Manitoba Public Insurance ("MPI") has decided against early adopting this standard and therefore this standard became applicable to MPI for the periods beginning March 1, 2013 and the transition date being March 1, 2012.

This letter is to confirm the following on the IAS 19R impact assessment paper that was prepared and reported on as at May 15, 2012:

- The impact analysis prepared in 2012 will remain valid in all aspects except for the transition date which will now be March 1, 2012 and not March 1, 2011.
- Our analysis on the impact of the changes to MPI as a result of IAS19R continues to be valid, specifically including the following:
  - Components of pension expense and their impact on financial results and the presentation within equity
  - Transition restatements as noted as at March 1, 2011 will continue to apply as at March 1, 2012 which is the transition date for the standard when it is not early adopted
  - Disclosures
  - Other matters
- Our analysis of the significant differences upon application of the IAS 19R also remains valid, specifically including the following:
  - Recognition
  - Measurement
  - Termination benefits
  - Discussion of the state plan
  - Short term employee benefits
  - Disclosures
- Our analysis of the options available to MPI as noted in section 3.0 on the recognition of actuarial gains and losses also continues to be valid.
- Updates from the report dated May 15, 2012:
  - MPI has elected to accumulate all actuarial gains and losses within another component of equity - accumulated other comprehensive income (AOCI) on a prospective basis. The balance of actuarial losses as at March 1, 2013 is $9.1 million for the basic line of business. This will represent a transfer from the rate stabilization reserve to AOCI relative to what was previously reported in MPI's February 28, 2013 results.

Yours sincerely,

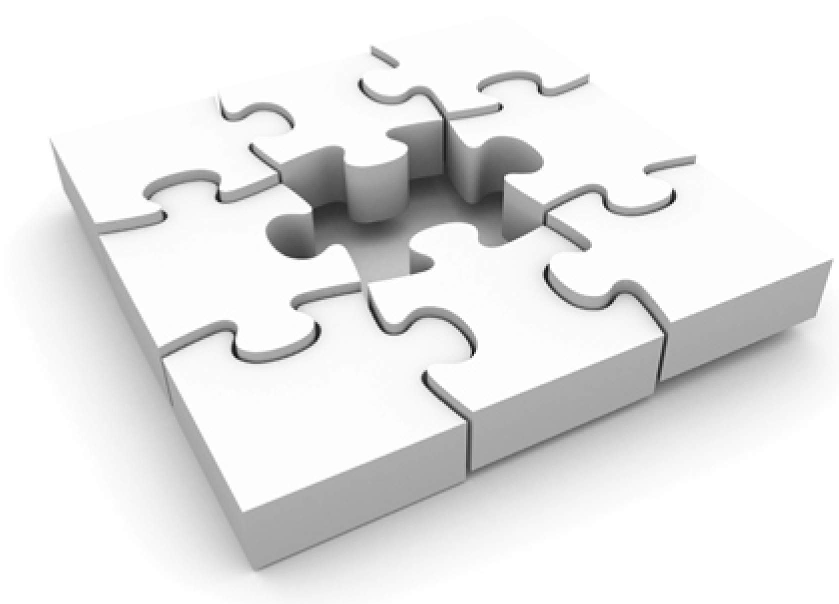
Deloitte LLP

Chartered Accountants

Deloitte.

Manitoba Public Insurance

Impact of IFRS 4 Phase II – Insurance contracts



August 30, 2013

Preface:

The analysis of IFRS 4 Phase II within this report is prefaced by the following:

- This standard has not been finalized and is currently in exposure draft form. The actual impacts as illustrated in this report may be significantly different upon adoption of the standard.
- The impacts as presented throughout the report are based on market conditions existing at the time of writing this report and will be significantly different upon adoption of the standard.
- The standard is not likely to be effective until at least periods beginning on or after January 1, 2017. Assuming this effective date; there is no impact to the General Rate Application for Manitoba Public Insurance for 2014 or 2015.
- The comments made within this report are based on the interpretation of the exposure draft of IFRS 4 – Phase II – Insurance contracts as issued by the IASB in June 2013. Interpretations of the standard will evolve as the standard comes closer to being effective. This report does not constitute an opinion and represents a summary of the potential impacts to MPI as a result of transition to the standard based on current information available at the date of this report.

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Section 1.0 – Executive summary

Background

The International Accounting Standards Board (IASB), responsible for International Financial Reporting Standards (IFRS), published a revised exposure draft on IFRS 4 (phase II) Insurance Contracts in June 2013. The revised exposure draft seeks to re-expose certain key aspects of measuring the insurance liability and represents the latest step in the development of a comprehensive IFRS for insurance contracts.

The IASB Board intends the comment period on the proposals to end on October 25, 2013. Once comments are received, mandatory implementation would be required for fiscal years ending a minimum of three years from the date that the Board publishes the standard. This would be for fiscal years beginning on or after January 1, 2017 at the earliest. Deloitte currently believes that the likely implementation date will be January 1, 2018; for MPI this is likely to be for the 2017/2018 fiscal year ending February 2018. The current Exposure Draft states that earlier adoption will be permitted and retrospective application will be required subject to limited relief in certain circumstances.

The purpose of this document is to outline the key aspects and changes from the existing standard contemplated within the 2013 exposure draft that have possible significant implications to Manitoba Public Insurance ("MPI" or "the Company"). The effective date of this analysis is August 16, 2013. It is important to note that interpretations of the standard may evolve over time as the standard is finalized by the International Accounting Standard Board and as other entities consider the impacts of implementation of the standard.

Limitations on reliance

This report has been produced for management of MPI for the purpose of responding to the Public Utilities Board "PUB" on the potential implications of the IFRS 4 Phase II Exposure Draft. It is neither intended nor suitable for any other purpose.

With the standard still in exposure draft and an effective date not prior to January 1, 2017, the interpretations and analysis provided within this report are limited to our understanding of the exposure draft at the current date. Subsequent interpretations may arise through the final development of the standard, which may be different to what is presented here.

The quantitative analysis within the report is based on the February 28, 2013 financial results of MPI, the projected net income within the statement of operations over fiscal years 2013/2014 to 2017/2018 and the assumptions within those financial statements as provided by management of MPI, and the external actuarial valuation of liabilities as at February 28, 2013. In assessing the potential quantitative impact, current market conditions have been taken into account. The final quantitative impact to MPI's accounts will not only depend on the finalized standard but also on actual experience and market conditions prevailing at the time of transition.

As a result of the standard still being in exposure draft and current company and market economics being used to illustrate the potential impact of the standard, the final impacts at the time of adoption may be significantly different than those presented in the report.

Disclaimer

The comments made within this report are based on the interpretation of the exposure draft of IFRS 4 – Phase II – Insurance contracts as issued by the IASB in June 2013. This report does not constitute an opinion and represents a summary of the potential impacts to MPI as a result of transition to the standard. The information provided within this report is based on the facts and circumstances provided to us by management of MPI and we accept no responsibility for the completeness or accuracy of such information.

Summary of impacts to MPI

IFRS 4 Phase II requires insurance contracts to be valued using a current value approach that incorporates all of the available information which is consistent with observable market information. Due to the requirement of incorporating observable market information at the date of valuation, earnings are likely to be subject to a greater degree of volatility than they currently are, especially where any mismatches exist between assets and liabilities.

In addition, the presentation of profit will separate out underwriting performance and any impact on liability assessment due to changes in discount assumptions. Any changes in liability due to changes in discounting assumptions will be reported under other comprehensive income (OCI) and, as such, will accumulate within accumulated other comprehensive income rather than within retained earnings or the Rate Stabilization Reserve "RSR". This impact will likely be offset by unrealized gains and losses on marketable bonds that will also be recognized through OCI assuming they are eligible for re-designation on transition.

Key areas that are likely to be impacted by the revised exposure draft are summarized in the table below:

Table 1: Summary of impacts

Item	Description	IFRS4 Phase I (Effectively current Canadian GAAP)	IFRS4 Phase II
1	Approach used to model insurance contract liabilities	The current standard does not explicitly specify a particular approach to be used for insurance contracts.	The new standard specifies two different approaches to be applied to insurance contracts. The two approaches specified are the building block approach (BAA) and the premium allocation approach (PAA). The BBA must be applied to MPI's post claim liabilities, where post claim liabilities refer to liabilities associated with claims which have already occurred regardless of whether or not they have been reported. The PAA is a simplified method and may be applied to MPI's pre-claim liabilities if certain conditions are met, where pre claim liabilities refer to liabilities associated with claims which have yet to occur as at the date the financial statements are produced; if the conditions are not met, the BBA will apply. We have assessed that it is possible to apply the PAA.

Item	Description	IFRS4 Phase I (Effectively current Canadian GAAP)	IFRS4 Phase II
2	Derivation of discount rate	The discount rate is selected based on the assets supporting the liabilities plus a margin for investment return risk. The current approach adopted in MPI's valuation of liabilities uses the same discount rate (based on the average duration of liabilities) for all cash flows, regardless of when they are paid, which is common industry practice under the current accounting standard.	Insurance contract liability cash flows are to be discounted using discount rates that reflect the characteristics of those cash flows. The discount rate should be derived using either a top down or bottom up approach. The approach MPI currently use to derive discount rates will need to be updated to reflect the characteristics of the liabilities, including timing of cash flows, rather than the assets backing those liabilities.
3	Presentation of the impact of discount rate changes on liabilities	The impact on the valuation of insurance liabilities due to a change in the discount rate is reflected through net income.	Discount rates are locked in at contract inception for net income purposes; however, the rates used at each valuation date need to be current for the statement of financial position. The impact on the valuation of insurance liabilities due to a change in the discount assumption in subsequent measurements will be presented separately through other comprehensive income (OCI).
4	Presentation of the impact of unrealized gains/losses on marketable bonds	Currently changes in discount rates impacting marketable bonds are reflected in net income to offset changes recognized on the policy liabilities.	At the date of transition MPI will likely have the ability to re-designate their marketable bond portfolio so changes in discount rates impact OCI, which is consistent with the treatment for insurance liabilities as noted above.
5	Risk adjustment	Margins are currently included for claims and premium liabilities. Although guidance is provided around setting margins, there is no prescribed methodology to determine the claims margin.	A risk adjustment is to be applied to the expected present value of liabilities. Although there is no prescribed methodology for determining the risk adjustment, if an entity uses a technique other than the confidence level technique it will be required to disclose a translation of the result of that technique into a confidence level.
6	Deferred acquisition costs "DAC"	Reflected on the statement of financial position as an asset and amortized over the term of the insurance contracts with premium deficiencies being reflected as a write-down.	There is a policy choice to expense acquisition costs as incurred or to include the cash flows of directly attributable acquisition costs within the insurance contract liability and therefore recognized immediately within the insurance contract liability. Under PAA, directly attributable acquisition costs can be amortized over the coverage period, although no explicit DAC asset is allowable.
7	Onerous contract liability	An assessed onerous contract liability (where carried premiums less acquisition costs are not likely to be sufficient to pay for claims, including a risk margin, and expenses) can be written down against deferred acquisition cost assets with any additional liability being recognized immediately.	An assessed onerous contract liability (where carried premiums less directly attributable acquisition costs are not likely to be sufficient to pay for claims, including a risk margin, and expenses) is to be recognized immediately.

Source: Table produced by Deloitte LLP based on current understanding of 2013 Exposure Draft for Insurance as at August 2013.

The following table shows the potential impact on MPI's 2013 year-end statement of financial position assuming the exposure draft was applied to the 2012/2013 financial year (note 1). The 2012/2013 reported statement of financial position is for basic policies as per the actuarial valuation of liabilities as at February 28, 2013.

Table 2: restatement of 2012/2013 statement of financial position

Statement of financial position $'000s	2012/2013 REPORTED	2012/2013 RESTATED
ASSETS		
Deferred acquisition costs	3,884	-
Total assets	**3,884**	**-**
LIABILTIES		
Unearned premiums	349,164	331,593
Onerous contract liability		11,875
Provision for unpaid claims	1,424,498	1,434,373
Total Liabilities	**1,773,662**	**1,777,841**
RETAINED EARNINGS		
RSR	141,469	133,406
Retained earnings	-	-
Total retained earnings	**141,469**	**133,406**

Under the exposure draft, DAC assets will no longer be allowable. Instead, it will be permissible to spread directly attributable policy acquisition expenses over the contract coverage period. Doing so will reduce the unearned premium liability. Alternatively, where the PAA is applied, an entity may elect to recognize the directly attributable acquisition costs as an expense as they are incurred. This may be a preferable approach for companies wishing to reduce the administrative burden of performing this calculation where directly attributable acquisition costs are relatively stable each year. We have assumed that directly attributable acquisition costs will be spread over the coverage period.

An onerous contract liability has been assessed based on a comparison of 2012/2013 unearned premium reserves less an amount for directly attributable acquisition costs and expected claims and expenses. This is consistent with the current level of equity in the unearned premium as per the latest actuarial report.

A likely increase in the provision for unpaid claims has been assessed. The level of risk margins included in this assessment is similar to the amount of margin for adverse deviation included in the 2012/2013 actuarial valuation of liabilities. Therefore the overall increase in liabilities is mainly due to the impact of moving to discounting projected cash flows using a risk free yield curve instead of using a fixed discount rate derived with reference to the assets held backing the liabilities applied to the average duration of the liabilities. Given the long tailed nature of MPI's claims, the valuations of claims liabilities is extremely sensitive to the discount assumptions used; a small increase or decrease in the discount assumptions can have a significant impact on the valuation of liabilities. It should be noted that for illustrative purposes a risk free yield curve is being used as a proxy to derive discount rates that reflect the characteristics of the liability cash flows. The actual discount rates used on transition may be different based on the prevailing market rates and the methodology used to derive discount rate and adjust for liquidity.

In addition to the above noted impacts, on transition to IFRS 4, amounts previously accumulated within RSR or retained earnings for changes in discount rates impacting policy liabilities will be moved to Accumulated other comprehensive income "AOCI". Assuming that on transition the marketable bonds are

Note 1
The amounts reflected in this report are for illustrative purposes only. The impacts noted to the rate stabilization reserve are based on a hypothetical transition date of February 28, 2013 using market conditions that applied at this date and the impacts are to show the potential direction of an adjustment on transition and should not be relied upon to reflect actual expected results. As the standard is still in exposure draft and will not be effective until at least periods beginning on or after January 1, 2017, the quantitative impacts to MPI as disclosed in this report will be subject to change.

designated as “FVTOCI” under IFRS 9; the accumulated unrealized gains / losses on these instruments will also be moved from RSR to AOCI.

Impact on statement of operations

The potential impact on key aspects of MPI’s statement of operations for the 2013/2014 to 2017/2018 fiscal years is shown below.

Table 3: Incremental impact on statement of operations

Statement of operations - impact of change in assumptions $'000s	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Premium Impact					
Gain (loss) on amortization of directly attributable acquisition costs	(2,518)	206	810	723	683
Claims Impact					
Gain (loss) on claims and expenses	38,586	16,065	10,141	566	(3,362)
Gain (loss) on onerous contract liability	(15,214)	11,279	9,502	6,309	-
Net income: operating result change in liabilities	**20,854**	**27,549**	**20,452**	**7,598**	**(2,679)**
Increase in investment income - marketable bonds loss to OCI	**14,997**	**29,452**	**28,226**	**36,102**	**37,381**
Total impact on net income	**35,852**	**57,001**	**48,678**	**43,699**	**34,702**
OCI: Gain (loss) on change in discount rate	**3,256**	**27,566**	**28,334**	**44,724**	**49,066**
OCI: Gain (loss) on marketable bonds	**(14,997)**	**(29,452)**	**(28,226)**	**(36,102)**	**(37,381)**
Total impact on OCI	**(11,742)**	**(1,885)**	**108**	**8,623**	**11,684**

Overall, profitability is initially expected to be higher than currently forecasted under current accounting standards due to the impact of discounting the liabilities using a yield curve rather than using a discount assumption at a fixed duration. The decreasing trend over time reflects lower projected prior year claims run-off compared with what has been planned. It should be noted that projected net income is sensitive to the underlying assumptions used. Changes in these assumptions may lead to lower or higher levels of net income.

The onerous contract liability assessed in each of the 2013/2014 to 2015/2016 fiscal years reflects that ultimate claims plus expenses are expected to be higher than premium received in those years. It is assumed that MPI does not apply for any changes in rates in 2015/2016 and thereafter. Any onerous contract liability is to be recognized immediately under the current exposure draft.

With the changes in discount rates on policy liabilities going through OCI on transition to IFRS 4 Phase II, it is also expected that MPI will have the opportunity to re-designate their marketable bond portfolio to FVTOCI assuming certain conditions are met on transition. This will ensure that changes in discount rates impacting liabilities that flow through OCI will be offset by the change in the value of the underlying assets backing the liabilities. The offset for each forecasted year is reflected in the OCI captions in table 3.

Sensitivity of assumptions

As mentioned above, projected net income is sensitive to a number of assumptions used within the projection models. There are many assumptions which are required to assess the level of claims recognised in the projected statement of operations. Changes in these assumptions can significantly alter the assessment of claims. The following are the most significant assumptions that are considered to create the highest level of sensitivity within the projections:

- Discount Rates – Changes in the underlying discount rate used to value claims liabilities would significantly impact the value of the liabilities reflected on the statement of financial position. After initial recognition, changes in the discount rate within a given year would be reflected in other comprehensive income.
- Inflation - A 1% increase in claims inflation (with no adjustment to the nominal discount rates) could result in an $11m reduction in net income in the 2013/2014 statement of operations.
- Risk Adjustment - Moving to a higher level of risk adjustment based at an indicative 90th percentile (which would imply reserve adequacy to nine in ten years) could result in a $19m reduction in net income in the 2013/2014 statement of operations.
- The assessment of claims in the statement of operations is also sensitive to the payment patterns that have been used to assess cash flows. If actual claims run off patterns change over time, this may increase or decrease the assessment of claims.

Section 2.0 – Detail on impacts of IFRS 4

Building block and premium allocation approaches

Under the proposed standard, two methods for accounting for insurance contract liabilities are available:

Building Block Approach (BBA)

The BBA is used for measuring insurance contract liabilities for incurred claims (post claims liability) and the remaining coverage (pre claims liability), unless the Premium Allocation Approach (PAA) is applied to the pre claim liability (see below). The BBA is made up of two components: fulfillment cash flows and any contractual service margin (CSM):

1. Components of fulfillment cash flows:

   a) Expected cash flows: an explicit, unbiased and probability weighted estimate (i.e., the expected value) of future cash flows derived from the insurance contract.
   b) Time value of money: Future expected cash flows are to be discounted using discount rates that reflect the characteristics of those cash flows. .
   c) Risk adjustment: an adjustment for the uncertainty of timing or magnitude of future cash flows.

2. Contractual service margin (CSM): The margin that makes up the difference between the present value of expected future in-flows vs. the present value of expected future out-flows and the risk adjustment. The contractual service margin is included in order to eliminate the possibility of recorded profit on day one. CSM is never negative; any Day 1 loss would be taken through the statement of operations.

Premium Allocation Approach

The PAA is available as an option for use to measure the pre claims liability for insurance contracts where doing so would be a reasonable approximation to the BBA, or where the contract coverage period is one year or less. The approach is simple and relatively consistent with the approach for contracts with durations of one year or less in the current standard. The liability for remaining coverage is measured under this approach as follows:

a) The premium received at initial recognition less any amount recognized for cover provided in that period;
b) Less any payments that relate to acquisition costs;
c) Plus any onerous contract liability.

Given that policies issued by MPI provide one year of coverage, we believe it is reasonable that the PAA can be applied in measuring the pre claims liability for all of MPI's contracts. This conclusion is on the basis that all policies are in fact of no more than one year's duration.

Key elements affecting MPI

The changes proposed in the exposed standard, IFRS 4, *Insurance Contracts*, primarily affect the post claim liabilities.

Expected cash flows: probability weighted (mean) estimates

Post claims liabilities are to be estimated as probability weighted cash flows taking the following in to account:

- Information about claims already reported by policyholders;
- Other information about the known or estimated characteristics of the portfolio of insurance contracts;
- Historical data about the entities own experience, supplemented with other data where required, e.g., to allow for different portfolio characteristics for more recent business compared with historical business written, changes in trends, changes in underwriting and claim management practices; and
- Current price information, e.g., on reinsurance contracts.

Further to discussion with MPI, we have taken the appointed actuaries projections and assumptions as per the actuarial valuation as at February 2013 as a basis for calculating mean cash flows. It should be noted that as a probability weighted average, a small positive run-off on claims may be experienced over time. Where there is evidence of consistent adverse or positive run off of liabilities each year, the basis for the liability calculation under the exposure draft may be challenged by auditors. We have not reviewed the actuarial assumptions provided to assess whether there is likely to be positive or adverse run-off of prior year claims.

Any future changes that are made to the valuation basis may result in liabilities which are materially different to the numbers presented in this report.

Discount rates: Top-down or bottom-up approach

Under the proposed standard, cash flows are to be discounted using discount rates that reflect the characteristics of those cash flows. Current observable market prices of instruments with similar cash flows are expected to be used to derive discount rates, with adjustments being made to reflect differences in terms of timing, currency and liquidity. Although not explicitly stated within the current exposure draft, it is implied that a yield curve should be used, although the interpretation is subject to change as the exposure draft evolves and industry approaches are developed.

There are two options for determining the discount rate:

- Under the <u>top-down</u> approach, an entity would use a market rate for a portfolio of appropriate assets, which is then adjusted for factors that are not relevant to the insurance contract such as market risk premiums and for differences in the timing of cash flows such that the duration of assets is matched to the duration of liabilities; and
- The <u>bottom-up</u> approach starts with the market's risk-free rate and makes adjustments to arrive at an appropriate discount rate for liabilities, taking in to account differences in the liquidity characteristics of the financial instruments that underlie the rates observed in the market and the liquidity characteristics of the insurance contacts.

Effectively, the top down approach would be similar to taking, a rated bond (for example an “A” rated bond) which is adjusted to remove any built in credit risk allowance; the bottom up approach would start with risk free rate and add to it an allowance for the “illiquidity” premium. In theory the rates will approximate one another but will most likely not be identical.

To illustrate the potential impact of moving to discount rates which better match the liability cash flows, we have used the Canadian government bond yield curve as at end February 2013. This is effectively similar to applying a bottom up approach to determining the discount rate, where we have taken a risk free yield curve with no adjustments being applied for differences in liquidity characteristics. For liabilities that are linked to inflationary increases, an inflation adjustment of 2% has been applied to the nominal government bond yield curve to derive real discount rates, which represents MPI's long term view of inflation. Although we consider use of the government bond yield curve to derive discount assumptions as a reasonable approach for illustrative purposes, the actual discount rate applied on transition will need to allow for prevailing market risk free rates and any differences in the characteristics of the liability cash flows, if a bottom up approach is to be used. This is likely to result in higher discount rates than have been used in the projections below.

The impact on 2012/2013 year end liabilities is shown below.

Table 4:

2012/2013 $'000s	IFRS4	IFRS4 phase II	Impact
Net claim liabilities	1,424,498	1,434,373	9,875

Discount rates: Interest expense presentation

Future expected cash flows are to be adjusted for the time value of money. Discount rates will be locked in on initial recognition of an insurance contract; however, discount rates used at subsequent valuations are required to be current and will change at each valuation date depending on prevailing market conditions. As it is not possible to accurately forecast interest rates at the likely transition date, the discount rates used in the numbers illustrated are based on best available information that is currently available. The actual rate at transition will almost certainly differ to the assumptions used in our projections.

Under the proposed standard, upon initial recognition at adoption, interest expense associated with the discount rate is recorded through the statement of operations. Subsequent to initial recognition, any unwinding of discount assumptions used on initial recognition of the insurance contracts will be part of the statement of operations and all interest expense caused by changes in discount rate assumptions will flow through the statement of other comprehensive income (OCI). The projected effect on net income of the proposed standard is as follows:

Table 5:

$'000s	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Statement of operation: Unwind of discount assumption at initial recognition	(3,648)	(3,507)	(2,502)	(1,127)	727
OCI: Change in discount rate on gross best estimate liability	(3,256)	(27,566)	(28,334)	(44,724)	(49,066)
OCI: Unrealized losses on marketable bonds re-designated on transition	14,997	29,452	28,226	36,102	37,381

On transition, it is expected that an amount will be recognized in accumulated other comprehensive income for the cumulative effect of the difference between the expected present value of cash flows using current discount rates and the discount rates that applied when portfolios were initially recognized. However, the standard also states that an entity need not undertake exhaustive efforts to obtain objective information but shall take into account all objective information that is reasonably available and estimate the discount rates that applied at the date of initial recognition using an observable yield curve for at least three years before the date of transition. Given that the date of transition is not expected to be prior to 2017 at the earliest, we have discounted liabilities using yield curves starting from 2013. In the period between now and transition, the company should seek to retain all of the information it would need if the standard were to be implemented immediately to ensure sufficient “objective” information is available. Additionally the company should seek to also retain similar information for as many prior (to today) years as feasible.

The impact noted with respect to the change in the liability may be offset by changes in the marketable bond values that will also flow through OCI assuming certain conditions are met at the date of transition.

Risk margin analysis

The current exposure draft does not prescribe a specific methodology for calculating the risk margin that is required under the BBA. However, in order to meet the objectives of the risk adjustment, the following characteristics need to be considered:

a) Risks with low frequency and high severity will result in higher risk adjustments than risks with high frequency and low severity;
b) For similar risks, contracts with longer durations will result in higher risk adjustments than contracts with a shorter duration;
c) Risks with a wide probability distribution will result in higher risk adjustments than risks with a narrow distribution;
d) The less is known about the current estimate and its trend, the higher the risk adjustment; and
e) To the extent that emerging experience reduces uncertainty, risk adjustments will increase and vice versa.

The exposure draft also states that the risk margin is required to be measured in an explicit way and that if a technique other than the use of a confidence level is used; the entity is required to disclose the translation of the result in to a confidence level.

As an indication of how this requirement may impact the valuation of liabilities, we have carried out a high level assessment of the volatility of reserves at a 75th percentile confidence level using standard bootstrapping techniques on paid data going back to 2000 and also further back to 1994. It should be noted there is currently no specified approach to the methodology that should be used to determine the risk margin or to the confidence level that should be targeted; interpretation of the risk adjustment is subject to change as the exposure draft evolves and industry approaches are developed.

The results of the volatility assessment have been used to derive an indicative risk adjustment under the post claim liability. We have used the 75th percentile using bootstrapping on paid data to calculate the risk adjustment for all classes of business, although it is possible that different classes may require alternative approaches in selecting the confidence interval. The results have been compared against the risk margins selected by the appointed actuary as part of the February 2013 actuarial valuation of liabilities.

It should also be noted that given the claims volatility has been assessed using MPI's actual paid claims data, the full run off of claims has not been captured for longer tailed claims liabilities; hence the observed volatility may be understated for the Accident Benefits (Weekly indemnity) class of business.

The results are shown below:

Table 6: Assessment of risk adjustment

Class	Risk margin used in Feb 2013 actuarial valuation	Claims risk adjustment on 2014 claims	Paid bootstrapping (2000-2012 data)	Paid bootstrapping (1994-2012 data)	Selected claims liability factor	Selected claims risk adjustment on 2014 claims	Change in risk adjustment
Bodily Injury - Basic	15.0%	2,290	9.5%		**10.0%**	1,527	(763)
Property Damage - Basic	5.0%	1,044	4.7%		**5.0%**	1,044	-
Collision - Basic	7.5%	6,296	6.9%		**7.5%**	6,296	-
Comprehensive - Basic	7.5%	1,475	9.1%		**9.0%**	1,770	295
AB - Weekly Indemnity	15.0%	77,687		13.2%	**15.0%**	77,687	-
AB - Other (Indexed)	15.0%	71,884		15.8%	**15.0%**	71,884	-
AB - Other (Non-indexed)	10.0%	4,814		7.7%	**10.0%**	4,814	-
PIPP Enhancement & Other	15.0%	10,235			**15.0%**	10,235	-
Total		**175,725**				**175,257**	**(469)**

For premium liabilities, we have applied the claims liability risk adjustment factor with a 25% uplift to reflect the additional uncertainty associated with claims that may emerge from the unearned liability. The risk adjustments applied are shown in the table below:

Table 7:

Class	Claims liability risk adjustment	Premium liability risk adjustment
Bodily Injury - Basic	15.0%	18.75%
Property Damage - Basic	5.0%	6.25%
Collision - Basic	7.5%	9.38%
Comprehensive - Basic	7.5%	9.38%
AB - Weekly Indemnity	15.0%	18.75%
AB - Other (Indexed)	15.0%	18.75%
AB - Other (Non-indexed)	10.0%	12.50%
PIPP Enhancement & Othe	15.0%	18.75%

Deferred Acquisition Costs (DAC)

Under the BBA, deferred acquisition costs are no longer recognized as an asset and amortized over time. Instead, directly attributable acquisition costs can be 'baked-in' to the insurance contract liability and therefore recognized immediately within the insurance contract liability. Under the PAA, directly attributable acquisition costs can be amortized over the coverage period, although no explicit DAC asset is allowable. Alternatively, where the PAA is applied, an entity may elect to recognize the directly attributable acquisition costs as an expense as they are incurred; this may be a preferable approach for companies wishing to reduce the administrative burden of performing this calculation where directly attributable acquisition costs are relatively stable each year. For illustrative purposes, we have assumed that directly attributable acquisition costs will be spread over the coverage period

Onerous contract liability

As part of the PAA, an assessment of onerous contract liability needs to be carried out. The onerous contract liability is the difference between the carrying amount of liability for the remaining coverage and the fulfillment cash flows which are defined to be the present value of expected claims plus a risk adjustment. The amount of onerous contract liability is determined with reference to a portfolio of contracts. Further to discussions with MPI, we have modeled all of the basic policies as a single portfolio. Should management define portfolios differently, the total resulting onerous contract liability may be different.

Based on MPI's planned loss ratios and allowing for discounting and a risk adjustment, potential onerous contract liabilities have been assessed for fiscal years 2013/2014 to 2015/2016. It should be noted that in calculating the onerous contract liability, we are comparing expected future claims and expense payments against unearned premium less an amount for directly attributed acquisition costs which have been taken as commission payments as per MPI's operational plan.

The assessed onerous contract liability is summarized below:

Table 8:

$'000s	2012/2013 (restated)	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Unearned premium reserve (UPR)	349,164	370,101	394,636	412,919	431,984	449,542
Directly attributable acquisition costs (5% comm)	(17,571)	(15,053)	(15,259)	(16,069)	(16,791)	(17,474)
UPR less directly attributable acquisition costs	331,593	355,048	379,377	396,850	415,193	432,068
Premium Liability	343,468	382,137	395,188	403,159	413,470	422,410
Onerous contract liability	**11,875**	**27,089**	**15,811**	**6,309**	**-**	**-**
Assumptions used:						
Undiscounted accident year loss ratio	73.09%	76.27%	74.56%	73.37%	72.85%	72.53%
Discounted loss ratio, including risk margin	78.74%	82.89%	80.34%	78.35%	76.78%	75.32%
Maintenance expense	2.92%	2.83%	2.78%	2.65%	2.62%	2.62%
PIPP	0.96%	0.96%	0.96%	0.96%	0.96%	0.96%
Internal loss adjustment expense	20.00%	20.00%	20.00%	20.00%	20.00%	20.00%

Reinsurance

Under the proposed standard, reinsurance cash flows, assets and liabilities are to be assessed and reported on explicitly within the financial statements. Also, counterparty risk (or credit risk, the risk of a reinsurer not meeting its commitments) must be included in the calculation of reinsurance assets.

Given that the MPI has minimal amounts of ceded liabilities, we do not expect there to be a significant financial impact for MPI.

Unbundling of insurance contracts: Bifurcation of distinct components

The 2013 exposure draft of IFRS 4 outlines three specific items within insurance contracts that should be unbundled: Embedded derivatives, Goods and non-insurance services, and investment components. The unbundling of these elements was analyzed as part of the initial transition to IFRS in 2011. Further assessments may be warranted as the standard evolves or based on any changes to the portfolio of products offered by MPI in the future prior to the adoption of the standard.

Effect of transition on rate stabilization reserve

Under the proposed standard, the rate stabilization reserve would be affected in two ways:

1. Retrospective application of IFRS 4 would cause the difference in calculation of the insurance contract liability upon initial recognition to be charged through opening retained earnings which would impact the rate stabilization reserve; and
2. IFRS 4 requires that interest expense caused by changes in discount rates be recorded in other comprehensive income. These changes in interest expense will not be recycled through net income and will be held within Accumulated Other Comprehensive Income (“AOCI”). As part of the analysis within the “Summary of impacts to MPI” section we have analyzed the impact of changes in the discount rate and amounts that will be reflected in AOCI relative to changes reflected within the rate stabilization reserve (“RSR”). This impact will be offset by the reclassification of unrealized gains/losses on marketable bonds from RSR to AOCI as described below in the “Effects of IFRS 4 on Financial Instruments”. Moving forward past transition, the impact of changes in the discount rate from IFRS 4 phase II as well as from unrealized gains and losses as a result of changes in interest rates impacting marketable bonds that are eligible for the FVTOCI option will be recognized in OCI with realized gains and losses on the instruments being recycled through net income on disposal. This will create a potential mismatch moving forward. There will be other reasons for mismatches moving forward under the current proposals:

    a) Not all assets backing the liabilities will be eligible for OCI treatment under IFRS 9. It is expected that many fixed income instruments will not be eligible for a variety of reasons;
    b) There will be duration mismatches between assets and liabilities which is assessed to be the case for MPI given current asset and liability portfolios; and
    c) Any derivative used would not be eligible for OCI treatment and changes in their fair value would be recorded through net income.

Effects of IFRS 4 on financial instruments

As discussed above, under the proposed standard, interest expense caused by changes in discount rates subsequent to initial recognition will be recorded in the statement of other comprehensive income. At the time of transition it is expected that an election will be available to record certain liability-backing bonds as FVTOCI, therefore reducing the possible accounting mismatch. This will then also reduce the transitional impact on the rate stabilization reserve. It is possible that not all bonds in the marketable bond portfolio will be eligible for this treatment and further analysis will be required at transition to determine if all of the securities meet the requirements for this designation.

Assuming that on transition to IFRS 9 MPI is eligible to have their equity portfolio designated as FVTOCI; the following is a summarized statement of operations from 2013/2014 to 2017/2018 using the information from the statement of operations section within the executive summary as a base:

Table 9:

Statement of operations - impact of change in assumptions $'000s	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Premium Impact					
Gain (loss) on amortization of directly attributable acquisition costs	(2,518)	206	810	723	683
Claims Impact					
Gain (loss) on claims and expenses	38,586	16,065	10,141	566	(3,362)
Gain (loss) on onerous contract liability	(15,214)	11,279	9,502	6,309	-
Net Income: Operating Result Change in Liabilities	20,854	27,549	20,452	7,598	(2,679)
Increase in investment income - marketable bonds loss to OCI	14,997	29,452	28,226	36,102	37,381
Remove realized gains on equities	(57,761)	(22,834)	(10,440)	(10,733)	(11,236)
Total increase (decrease) on net income	**(21,909)**	**34,167**	**38,239**	**32,967**	**23,465**

The mandatory effective date of IFRS 9 (2010) is for periods beginning on or after January 1, 2015. However, as part of the Limited Amendments to the IFRS 9 project, on July 24, 2013 the IASB tentatively decided to defer the mandatory effective date of IFRS 9 and that the mandatory effective date should be left open pending the finalization of the impairment and classification and measurement requirements within IFRS 9 (2010).

Appendix 1: projected statement of operations

Projected statement of operations

Table 1.1 shows a summary of MPI's planned statement of operations over 2013/2014 to 2017/2018. Table 1.2 shows a summary of the projected statement of operations under the exposure draft. The differences in net income between each of the projections and impact to OCI are shown in table 1.3.

It should be noted that the presentation in table 1.2 does not show the full presentation that would be required under IFRS4 phase II. For example, IFRS4 phase II requires separate disclosure for gross and reinsurance amounts; also, change in risk adjustment and contractual service margin is to be disclosed separately. There are other IFRS4 phase II disclosure requirements that may apply.

Table 1.1: MPI projected statement of operations

MPI's current projected statement of operations $'000s	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Net written premium	786,655	838,709	877,244	917,405	954,618
Earned premium	786,623	834,720	881,027	922,135	962,886
Claims cost	770,300	774,706	791,050	800,632	830,780
Total other expenses	125,399	130,535	133,587	138,672	144,255
Net income (loss)	(109,076)	(70,521)	(43,610)	(17,169)	(12,149)
Investment income	114,547	63,027	45,787	37,668	36,389
Net income (loss) from operations	5,471	(7,494)	2,177	20,499	24,240

Table 1.2: Projected statement of operations[2] using IFRS4 phase II assumptions

IFRS4 potential projected statement of operations $'000s	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Insurance contract revenue	**784,105**	**834,926**	**881,837**	**922,858**	**963,569**
Claims incurred	**746,928**	**747,363**	**771,407**	**793,757**	**834,142**
Expenses incurred	**125,399**	**130,535**	**133,587**	**138,672**	**144,255**
Net income (loss) / Gross margin	**(88,222)**	**(42,972)**	**(23,158)**	**(9,571)**	**(14,828)**
Investment income aspreviously projected	**114,547**	**63,027**	**45,787**	**37,668**	**36,389**
Marketable bonds unrealized loss to OCI**	**14,997**	**29,452**	**28,226**	**36,102**	**37,381**
Remove realized gains on equities*	**(57,761)**	**(22,834)**	**(10,440)**	**(10,733)**	**(11,236)**
Net income (loss) from operations	**(16,438)**	**26,673**	**40,416**	**53,466**	**47,705**
Impact to other comprehensive income (OCI)					
Gain (loss) on change in discount rate on best estimate liability	3,256	27,566	28,334	44,724	49,066
Unrealized Gain (loss) on marketable bonds**	(14,997)	(29,452)	(28,226)	(36,102)	(37,381)
Realized gains on equities*	57,761	22,834	10,440	10,733	11,236
Impact to OCI	**46,019**	**20,949**	**10,548**	**19,356**	**22,921**

Table 1.3: Differences in net income and impact to OCI

$`000s	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Total increase (decrease) on net income	**(21,909)**	**34,167**	**38,239**	**32,967**	**23,465**
Total impact to OCI	**46,019**	**20,949**	**10,548**	**19,356**	**22,921**

[2] This presentation does not show the full presentation that would be required under IFRS4 phase II. For example, IFRS4 phase II requires separate disclosure for gross and reinsurance amounts; also, change in risk adjustment and contractual service margin is to be disclosed separately. There are other IFRS4 phase II disclosure requirements that may apply.

*Assuming equities are classified as FVTOCI in transition to IFRS 9.
**Assuming that marketable bonds are classified as FVTOCI under IFRS 9 on transition to IFRS 4 Phase II.

Appendix 2: sensitivity analysis

Risk adjustment sensitivity analysis

The impact of using risk adjustments at the 75th, 80th and 90th percentile level of confidence have been investigated, where the risk adjustment has been assessed using basic bootstrapping techniques applied to MPI's paid claims data. Although we have selected the 75th percentile to calculate the risk margin in this report, it should be noted that the exposure draft does not state what level of confidence is to be used in assessing the risk adjustment, nor the approach that should be used to calculate the risk adjustment. Rather management will need to determine what level it is using, disclose that and potentially need to justify it, at least to its auditor.

It should also be noted that given the claims volatility has been assessed using MPI's actual paid claims data, the full run off of claims has not been captured for longer tailed claims liabilities; hence the observed volatility may be understated for the Accident Benefits (Weekly indemnity) class of business.

Table 2.1 below shows the approximate claims risk margins at varying levels of confidence. Table 2.2 shows the assessment of net claims liabilities at each of the projected year ends using varying levels of risk adjustments. Table 2.3 shows the incremental impact on MPI's planned operating result after application of the selected claim risk adjustment to the claims liability. In addition, it is assumed that the risk adjustment is increased by 25% when making the onerous contact liability assessment.

Table 2.1: Claims risk adjustment at selected percentiles:

Class of business	As per actuarial report	75th %ile	80th %ile	90th %ile
Bodily Injury - Basic	15%	10.00%	12.0%	15.0%
Property Damage - Basic	5%	5.00%	7.0%	8.0%
Collision - Basic	8%	7.50%	9.0%	11.0%
Comprehensive - Basic	8%	9.00%	12.0%	15.0%
AB - Weekly Indemnity	15%	15.00%	16.0%	20.0%
AB - Other (Indexed)	15%	15.00%	22.0%	25.0%
AB - Other (Non-indexed)	10%	10.00%	10.0%	12.0%
PIPP Enhancement & Other	15%	15.00%	16.0%	20.0%

Table 2.2: Claims liability valuation using varying levels of risk adjustment:

Claims liability for each level of risk adjustment $000's	2012/2013 (restated)	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Actuarial report	1,434,829	1,428,998	1,427,705	1,426,412	1,403,865	1,373,182
75th %ile selected	**1,434,373**	**1,428,530**	**1,427,272**	**1,426,013**	**1,403,500**	**1,372,848**
80th %ile	1,476,021	1,470,509	1,469,013	1,467,446	1,443,905	1,411,950
90th %ile	1,517,919	1,512,230	1,510,619	1,508,953	1,484,672	1,451,723

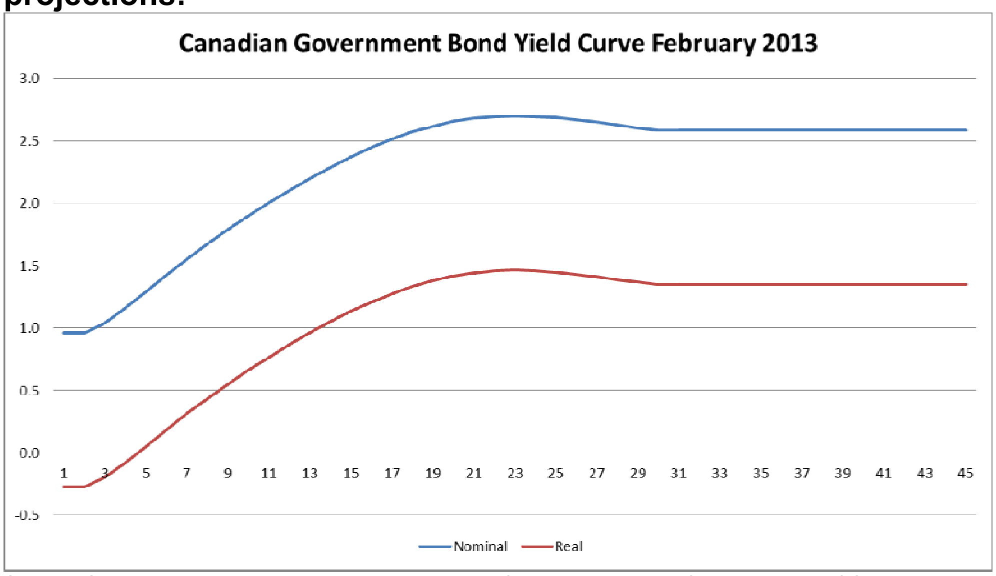
Table 2.3: Incremental impact on net income using varying levels of risk adjustment:

Net income for each level of risk adjustment - impact of change in assumptions $000's	2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
Actuarial report	21,500	27,612	20,506	6,926	(2,649)
75th %ile selected	**20,854**	**27,549**	**20,452**	**7,598**	**(2,679)**
80th %ile	11,594	27,519	20,603	10,157	6,408
90th %ile	1,998	27,327	20,516	10,670	7,217

Discount rate sensitivity analysis on claims liabilities

The discount assumptions used in our calculations are based on the Canadian government risk free yield curve as at February 28th, 2013. As can be seen from the diagram below, Canadian government bond returns follow a typical yield curve, increasing over time. Where MPI has outstanding claims with longer tailed durations, these liabilities will be discounted using higher discount rates as per the yield curve.

Graph 1: Canadian government bond yield curve and real yield curve assumed in projections:



Source: Graph produced by Deloitte LLP based on information obtained from the Bank of Canada supplemented with Deloitte projections for illustrative purposes

The Canadian government bond yield curve is only available up to durations of 29 years. For liabilities longer than this, a flat yield curve has been assumed based on the yield in year 29, although it should be noted that other approaches may be considered appropriate for projecting the yield curve beyond 29 years.

Some of MPI's liabilities are indexed. For these liabilities, a real yield curve is used which accounts for MPI's long term forecast for inflation of 2%. For durations less than 4 years, this results in discount rates less than zero to reflect that inflation is higher than the returns available on short duration government bonds.

Some of MPI's Accident Benefit liabilities are payable as weekly annuities. Due to lack of detailed information on each outstanding annuity, these liabilities have been assessed at a high level using a spot rate assumption applied at an average duration rather than using a yield curve and payment pattern. This approach should give a reasonable approximation to the overall assessment of liability.

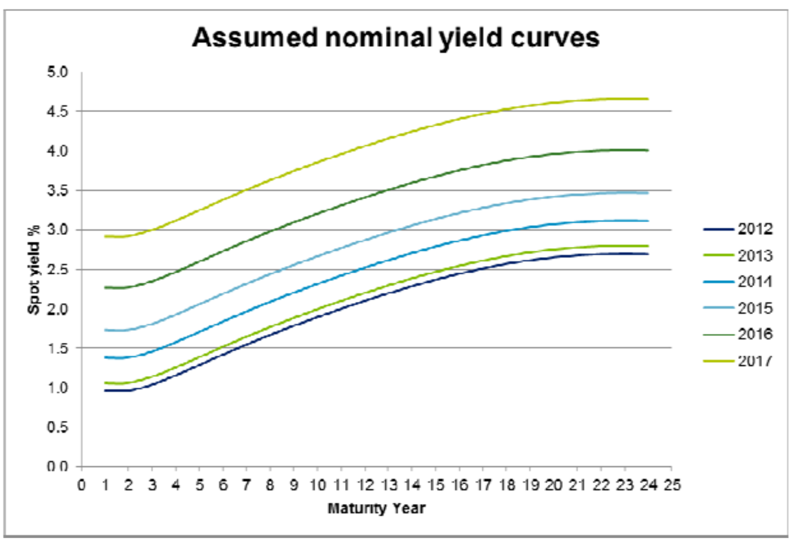
For fiscal years 2013/2014 to 2017/2018, it has been assumed that the yield curve will retain the same shape as the yield curve as at end February 2013 but the following increases have been applied, which are consistent with MPI's projections used for future investment returns based on a 10 year government bond:

Table 2.4: Increase in yield curve applied for each projection year:

Financial year end	Increase in yield curve (basis ooints)
2014	10
2015	32
2016	35
2017	54
2018	65

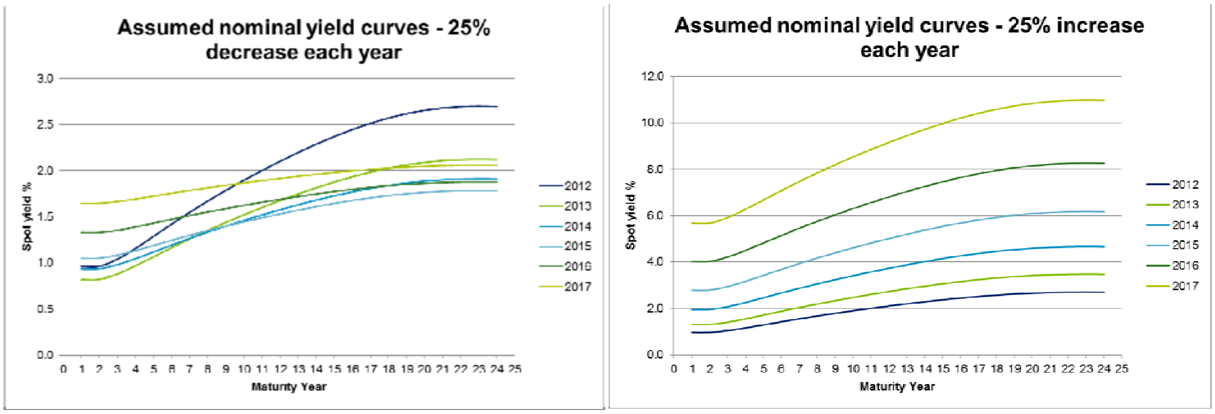
Source: Table produced by Deloitte LLP based on assumptions provided by MPI

Graph 2: Assumed nominal yield curves for each projection year:



Based on two scenarios where the yield curve increases by 25% year on year and decreases by 25% year on year, the potential impact on liabilities has been assessed. The graphs below illustrate the change in yield curve for each valuation year:

Graph 3: Yield curve allowing for decreases and increases each year:



It should be noted that an increase in yield curves would reduce the market value of bonds and most likely result in investment returns which are higher than planned; although this has not been factored in to the projections. Similarly, a decrease in the yield curve would increase the market value of bonds and most likely result in lower investment returns than planned.

The table below shows the incremental impact on MPI's projected statement of operations due to a change in yield curve assumptions.

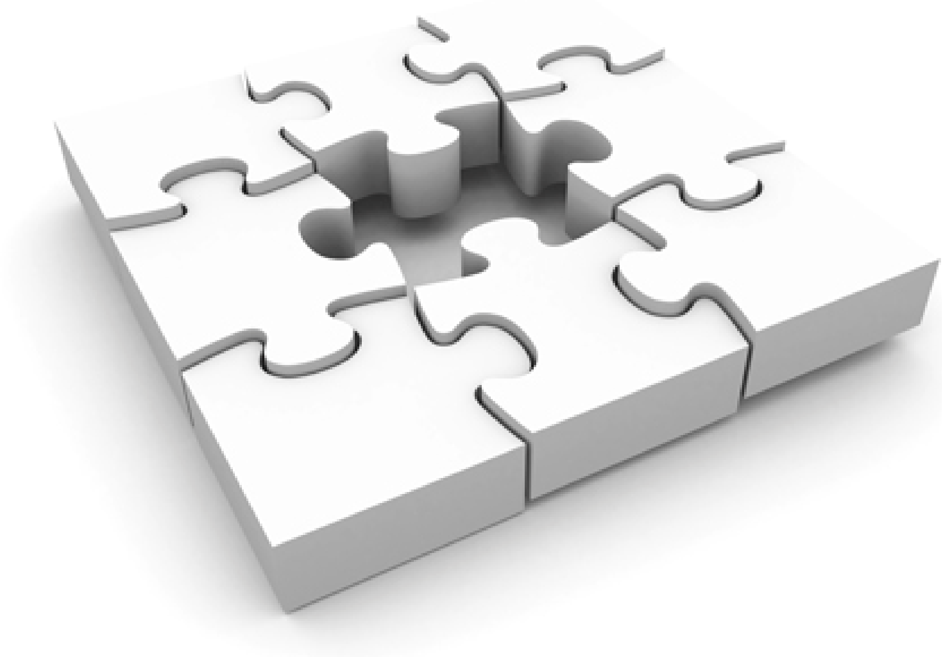
Table 2.5: Incremental impact on projected statement of operations due to change in yield curve

Statement of operations for each level of risk adjustment - impact of change in assumptions		2013/2014	2014/2015	2015/2016	2016/2017	2017/2018
25% increase in yield curve, year on year	Net income	25,517	34,485	31,099	12,759	12,608
	Gain (loss) on change in discount rate	14,853	41,120	48,503	68,028	75,993
Selected yield curve	Net income	20,854	27,549	20,452	7,598	(2,679)
	Gain (loss) on change in discount rate	3,256	27,566	28,334	44,724	49,066
25% reduction in yield curve, year on year	Net income	15,859	21,842	12,043	(1,174)	(8,364)
	Gain (loss) on change in discount rate	(9,152)	17,281	14,015	29,861	30,792

Deloitte.

Manitoba Public Insurance

Impact of IFRS 9



August 30, 2013

Preface:

The analysis of IFRS 9 – Classification and Measurement within this report is prefaced by the following:

- This full classification and measurement component of IFRS 9 has not been finalized with a portion of the standard currently in exposure draft form. The actual impacts as illustrated in this report may be significantly different upon adoption of the standard.

- The impacts as presented throughout the report are based on market conditions existing at the time of writing this report and will be significantly different upon adoption of the standard.

- There could be no impact to the 2014 or 2015 General Rate Application for Manitoba Public Insurance (MPI) as the IASB tentatively decided to defer the mandatory effective date of IFRS 9.

- On the assumption that the mandatory effective date of IFRS 9 is deferred until periods beginning on or after January 1, 2017; it is not expected that IFRS 9 will impact MPI for the purpose of the 2014 or 2015 General Rate Application. However; should the mandatory effective date remain for periods beginning on or after January 1, 2015; IFRS 9 may have implications for both the 2014 and 2015 general rate application.

- The comments made within this report are based on the interpretations of IFRS 9 at the date of this report. Interpretations of the standard will evolve as the standard comes closer to being effective. This report does not constitute an opinion and represents a summary of the potential impacts to MPI as a result of transition to the standard based on current information available at the date of this report.

IFRS 9: Classification and measurement

Background

The International Accounting Standards Board (IASB) Issued IFRS 9 Financial Instruments in October, 2010 ("IFRS 9 (2010) or IFRS 9) to replace standards for financial instruments outlined in IAS 39. The IASB Board intends that IFRS 9 will ultimately replace IAS 39 in its entirety. The Board divided its project to replace IAS 39 into three main phases (classification and measurement, impairment and hedge accounting). The analysis within this report is focused on the classification and measurement component of the standard.

On November 15, 2011, the IASB decided to consider making limited modifications to IFRS 9, and on November 28, 2012 the IASB issued an Exposure Draft Classification and Measurement: Limited Amendments to IFRS 9 (Proposed amendments to IFRS 9 (2010)) – ("Limited Amendments")

The mandatory effective date of IFRS 9 (2010) is for periods beginning on or after January 1, 2015. However, as part of the Limited Amendments to the IFRS 9 project, on July 24, 2013 the IASB tentatively decided to defer the mandatory effective date of IFRS 9 and that the mandatory effective date should be left open pending the finalization of the impairment and classification and measurement requirements within IFRS 9 (2010). IFRS 9 would still be available for early application.

Adoption of IFRS 9 will cause MPI to assess how its financial instruments are measured and classified, and will potentially result in differences to where gains and losses are recorded ("above the line" through the statement of operations or "below the line" through other comprehensive income).
The purpose of this document is to outline the key aspects and changes from IAS 39 contemplated within IFRS 9 (classification and measurement) and the possible implications to Manitoba Public Insurance ("MPI" or "the Company"). The effective date of this analysis is August 16, 2013 and it is important to note that interpretations of the standard may evolve over time as entities consider adoption.

Financial instrument classification (IFRS 9 (2010))

Under IFRS 9 (2010), financial instrument classifications are simplified: There are two available classifications: *Amortized cost* and *Fair Value through Profit or Loss (FVTPL)*, with an exception for equity investments that have the option to be recorded through Other Comprehensive Income (OCI) if they are not held for trading[1].

The basis for determining the classification under IFRS 9 is dependent on the business model used for managing financial assets and the contractual cash flow characteristics of the financial asset. If the objective of the entity's business model is to hold its assets to collect the contractual cash flows and the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI") on the principal amount outstanding, an entity generally must classify the asset at amortized cost. If both of these two conditions are not met for a financial asset, (e.g., the business model is a trading business), the entity generally must classify the assets as FVTPL.

It should be noted that there is judgment and interpretation involved in determining the nature of a "business model" and whether the SPPI contractual cash flow test is met for financial assets – the interpretation of which drove the re-opening of IFRS 9 (2010) through the Limited Amendments exposure draft.

The following is a summary of the classification implications of the main elements of MPI's financial instruments based on IFRS 9 (2010) without considering the implication of the Limited Amendments:

Investment component	Current presentation of changes in fair value (IAS 39)	IFRS 9 (2010) - implication
Bonds (Non-marketable)	N/A – held to maturity	N/A – held at Amortized Cost**
Bonds (Marketable)	FVTPL (using fair value option) – recorded through Net income	Amortized Cost** or FVTPL (using fair value option) - recorded through Net Income
Equity Investments (AFS)	AFS – recorded through OCI - Below the Line	FVTPL – recorded through net income or FVTOCI – recorded through OCI – Below the Line - if not held for trading1
Cash*	AFS – recorded through OCI***	Amortized cost - no change in value recorded
Short Term Investments*	AFS – recorded through OCI***	Amortized cost - no change in value recorded

* MPI's cash, short term investments, and accounts receivable balances will likely need to be classified as amortized cost given that the Company manages these assets to collect the contractual cash flows thereon and the cash flows represent payments of principal and interest. Practically speaking, this should not result in a transitional adjustment for MPI upon initial adoption of IFRS 9.

**Assumes that on the date of transition to IFRS 9 MPI's business model meets the contractual cash flow and SPPI test

***For these items there is typically no change in the underlying value of the instrument; and therefore there would typically be no amounts that flow through OCI

Key elements affecting MPI under IFRS 9 (2010)

The following discussion summarizes the potential changes in classification of MPI's financial instruments on transition to IFRS 9 relative to the current accounting treatment under IAS 39.

Classification of equities

All equities are to be held at fair value on the statement of financial position, with changes in value to be recognized in profit/loss. Note that an irrevocable election can be made at the initial recognition of an investment in each equity instrument to present in other comprehensive income (OCI) subsequent changes in the fair value of an equity instrument if it is not held for trading. If an election to use OCI is made, dividends on such investments are recognized in net income unless the dividend clearly represents a recovery of part of the cost of the investment.

Recognizing changes in value of equities through OCI would allow MPI to avoid potential earnings volatility caused by changing equity values (unrealized gains would not have to be recognized through profit/loss).

The following tables outline the projected implications on investment income of both methods on equities from the expected date of implementation (2015/16) forward. Figures are taken from tables 5.1 and 6.1 of Volume II – Investment Income in the 2014 public utilities board rate application. All amounts are presented in thousands of Canadian Dollars unless otherwise noted.

Recording changes in equity values through net income – "above the line"

The following table summarizes investment income recorded through the statement of operations with unrealized gains on equity through the statement of operations:

Equity investment income with equities FVTPL (projected 2015/16 – 2017/18)			
	2015/16	**2016/17**	**2017/18**
Total Equities Income, using existing IFRS standards – Per Rate Application	$25,578	$27,199	$29,761
Increase (decrease) in unrealized gain/(losses) if equities are at FVTPL – net income is adjusted by:	15,547	16,871	18,939
Total Equities Income– Equities are classified as FVTPL:	$41,125	$44,070	$48,700

It is important to note that the projections above are on the basis of equity markets being relatively stable.

The table below outlines potential volatility in investment income for the three most recent fiscal years if unrealized gains on equities were recorded through the statement of operations with equities being classified as FVTPL:

Equities investment income with equities FVTPL (actual 2010/11 – 2012/13)			
	2010/11	**2011/12**	**2012/13**
Total Equities Income – Previously reported	$28,543	$14,570	$18,432
Add/Deduct: unrealized gains /(losses) on equities	84,762	(24,604)	52,791
Total Equities Income –– FVTPL Option:	$113,305	$(10,034)	$71,223

Recording changes in equity values through OCI – "below the line"

Where MPI is eligible to classify equities as FVTOCI the impact going forward is that the realized gains and losses are never recycled back through the statement of operations and will therefore never impact net income.

The following summarizes the impact on investment income within the statement of operations with unrealized gains on equity (and realized gains) through the statement of other comprehensive income:

Equities investment income with equities FVTOCI (projected 2015/16 – 2017/18)			
	2015/16	**2016/17**	**2017/18**
Total Equities Income, using existing IFRS standards – Per Rate Application –***	$25,578	$27,199	$29,761
Remove: realized gains**	(10,440)	(10,733)	(11,236)
Total Equities Income– Equities are classified as FVTOCI:	$15,138	$16,466	$18,525

**No realized gains classified through OCI can be recycled back into profit/loss, although there may be interpretations that results in amounts relating to realized gains and losses being recycled through other components of equity such as the rate stabilization reserve. This interpretation is on the basis of other areas within IFRS such as IAS 19 (2011) which have balances recorded within AOCI that are never recycled through net income. This view is subject to further interpretation as the standard is implemented and practice guidance is given.

***Currently includes dividend income and realized gains on equities

It is also important to note that no impairment charges would be recorded in net income for equity instruments recorded within the FVTOCI designation under IFRS 9. Under IAS 39 MPI currently recognizes impairment charges on equities (AFS financial instruments) within investment income.

Impact of limited amendments to IFRS 9

The IASB published Exposure Draft ED/2012/4 Classification and Measurement: Limited Amendments to IFRS 9 (proposed amendments to IFRS 9 (2010)) on November 28, 2012, with comments due by March 28, 2013. The issuance of this exposure draft was in part to address transitional implications associated with the IFRS 4 Phase II. IFRS 4 Phase II also has no stated effective date.

The proposed changes would introduce a 'fair value through other comprehensive income' (FVTOCI) measurement category for particular financial assets.

The proposed new 'fair value through other comprehensive income' (FVTOCI) measurement category would include certain financial assets when two conditions are met:

- the contractual cash flows of the assets are solely payments of principal and interest and
- the assets are used in a business model which is neither to exclusively hold nor sell.

In addition, a newly introduced paragraph clarifies that gains or losses on a financial asset in the new measurement category would be recognized in other comprehensive income, with the exception of impairment losses and foreign exchange gains and losses. Upon disposal, any gain or loss previously recognized in other comprehensive income (OCI) would be recycled to profit or loss for the period.

From the perspective of MPI; the provisions outlined in the exposure draft will be important for the marketable bond securities that currently back policy liabilities. The provisions will potentially allow these securities to be classified as FVTOCI (assuming conditions are met on transition) which will offset the accounting mismatch that would have otherwise existed on transition to IFRS 4 Phase II.

Once IFRS 4 Phase II is adopted this classification would be preferred as it would reduce the accounting mismatch of interest rate changes on policy liabilities flowing through other comprehensive income (below the line).

The one issue is that there would be an inconsistency to how changes in the fair value of the marketable bonds are recycled through net income versus how changes in the discount rate impacting insurance liabilities will be recorded in Accumulated Other Comprehensive Income never recycled through net income. It should be noted the IFRS 4 Phase II is currently in exposure draft and the OCI presentation item is currently under review by the IASB as part of the exposure draft process.

Classification of marketable bonds – prior to adoption of IFRS 4

Currently marketable bonds are classified as FVTPL (value changes through net income) under IAS 39 using the fair value option on the basis that these instruments significantly reduce an accounting mismatch caused by changes in the value of insurance liabilities. The fair value option continues to exist under IFRS 9 and therefore there is not expected to be any impact on transition for MPI's marketable bond securities.

Effect of transition on Rate Stabilization Reserve ("RSR")

Based on the current effective date of January 1, 2015; the transition date for MPI would effectively be March 1, 2014; which would represent the date of the opening statement of financial position. Assuming that all of the equities currently classified as AFS would be classified as FVTOCI on transition to IFRS 9; it is not expected that there would be a significant impact on the rate stabilization reserve at March 1, 2014. The main impact would be due to any impairment loss amounts recognized in RSR relating to unrealized equity positions at the date of transition. These amounts would be moved from RSR to AOCI at the date of transition to IFRS 9.

In the event that the FVTPL option is used for equities; the impact at March 1, 2014 is estimated to be a $69.9M increase in the rate stabilization reserve. This is representative of the ending AOCI position at February 28, 2013 plus the expected impact of unrealized and realized gains and losses on Canadian and US equities during the 2013/2014 financial year.

Expected credit loss exposure draft

On March 7, 2013, the International Accounting Standards Board (IASB) issued for public comment an Exposure Draft ED/2013/3 Financial Instruments: Expected Credit Losses (the 'ED'). The proposals are intended to replace the guidance on impairment of financial assets in IAS 39 Financial Instruments. The expected credit loss model will impact the measurement, recognition, and disclosure of impaired financial assets on transition to IFRS 9. The standard is currently being evaluated with a final standard expected in 2014.

Disclaimer

The comments made within this report are based on the interpretation of IFRS 9 - classification and measurement ("the standard") as issued by the IASB in October 2010 other than the comments provided in the section titled "Impact of Limited Amendments to IFRS 9". This report does not constitute an opinion and represents a summary of the potential impacts to MPI as a result of transition to the standard. The information provided within this report is based on the facts and circumstances provided to us by management of MPI and we accept no responsibility for the completeness or accuracy of such information.

[1] A financial asset or financial liability is classified as held for trading if:
-it is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;
-on initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
-it is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).
<IAS 39, paragraph 9)