An Eccentric Journey: Lessons Learned and Conflicting Signals in the 2015/16 MPI GRA

November 13, 2014

Consumers' Association of Canada (Manitoba Branch)

CAC Manitoba

- Over two decades of rate hearings
- CAC Manitoba Interest: Core Consumer Rights:
  - **The right to be informed**
  - **The right to choose**
  - **The right to be heard**
  - **The right to consumer education**

Development of CAC Manitoba Position

- Day to day contact
- Focus groups/stakeholder advisory panels
- CAC Board

Focus Group/CAC Manitoba Board Focus

- Efficiency expectations
- Relationship between rate increases and inflation
- The value of road safety investments
- Risk tolerance and the RSR

Core Themes of CAC Manitoba Board

- Manitoba is the “show me” Province
- Importance of demonstrating good value for money:
  - Transparency
  - Accountability
  - Visible fiscal responsibility
  - Proven evaluations or precedent

Core Themes of CAC Manitoba Board (cont'd)

- Good value also involves good service for victims and cost effective road safety programs that reduce the social and economic costs of accidents
- Pensioners and wage earners feel fortunate to receive inflation level increases – a 3.5% increase is a lot

Core Rate Setting Questions

- Has MPI demonstrated that a 2.4% general rate increase and a 1% RSR surcharge is just and reasonable?
- Has MPI demonstrated that its alternative recommendation of a general rate increase in the range of 3.4 – 3.6% is just and reasonable?

A Quote CAC Manitoba Can Sympathize With

- *MR. REGIS GOSSELIN: And -- and at -- at the moment, I -- I don't feel I have enough information as a Board member to be able to say -- to quantify in dollar terms what the impact is of the rate changes that you have actually occurred.*
  - (Gosselin 1544) (context of interest rate forecasts)

Conflicting Signals (issues)

- CAC Manitoba has struggled to reconcile:
  - 2 bad years (will there be one more?)
  - Lack of clarity about what is driving inferior results and rate pressures
    - (a bad winter, materially increasing operating (IT) costs, risk taking related to asset/liability mismatches, failure to manage PIPP claims duration, reserving issues, reserving “lags”, computer implementation issues, short or long term trends in collision severity, failure to manage collision estimates, investment income uncertainty, missed opportunities in road safety investments)

Eccentric Hearing – Conflicting Signals

- A failure to listen to the PUB regarding benchmarking and cost control

The Just and Reasonable Rate Criteria

- Ensuring that forecasts are reasonably reliable;
- Ensuring that actual and projected costs incurred are necessary and prudent;
- Assessing the reasonable revenue needs of an applicant in the context of its overall general health (including reserves);
- Determining an appropriate allocation of costs between classes; and,
- Setting just and reasonable rates in accordance with statutory objectives.
  - *Order 98-14*, p. 28

Prudent and Necessary (Reasonable) Management of Costs

- Board's authority contested in motion leading to 98/14
- MPI maintains this position
  - (See also Kalinowsky, Tr. 417)

Prudent and Necessary (Reasonable) Management of Costs: Key Themes

- In the course of upgrading its information technology roof has MPI inadvertently neglected its core foundation of claims management and cost control?
- Has MPI inadvertently exposed basic ratepayers to inordinate risks by betting on the asset/liability duration mismatch?

Has MPI Been Neglecting its Foundations While Upgrading its Roof?

- All modern organizations must invest in IT
- But:
  - are investments delivering as promised?
  - are core strengths of MPI (including its people) being neglected in the rush to information technology solutions?
  - are the cost containment benchmarks necessary to provide meaningful efficiencies being put in place?
  - is there a disconnect between claims of IT Value for Manitobans and evidence?

Has MPI Been Neglecting its Foundations While Upgrading its Roof? (cont’d)

- See PUB (MPI) 1-74(c) attachment
- 2009/'10 to 2013/'14 - a $27 million difference
- Compound annual growth 17.9%
  - (Reichert, 1493)

Has MPI Been Neglecting its Foundations While Upgrading its Roof? (cont'd)

- 2014/'15 and projected'18/'19 in excess of $23 million
  - (Reichert, 1494)
- 7 percent compound annual growth rate increase
  - (Reichert, 1494)

Has MPI Been Neglecting its Foundations While Upgrading its Roof? (cont'd)

- Note: does not include $3.5 M associated with Mitchell for Body repair shops
  - (Reichert 1484/86, 1489, MPI Exhibit 64)

Where was the cost containment framework for BI3?

- The Corporation does not have a cost containment framework in place to the same extent as it does a service commitment framework.
- *[W]ith respect to BI3, that the Board had indicated previously an expectation that the information gleaned by MPI would be used to benchmark its outcomes with those of similar organizations, with a view to reducing claimants' disability durations and optimizing their recovery time. This has not yet occurred...*
    - (*Order 151*/13, p. 24)
    - (See also PUB 1-63 and Reichert, 1285)

The Promise of BI3 – MPI Says

- The Corporation has done many things in the past to ensure that the biggest expense it has – claim costs – is managed with state-of-the-art systems.
- The very aggressive Business Process Review project, that began in 2005 and was just completed in 2013, was instrumental in allowing the Corporation to **control claims costs**.
  - (Pre-filed testimony of Dan Guimond, p. 13) (emphasis added)

PIPP – BI3 – MPI Says

- It would deliver increasing consistency in claims handling between case managers.
  - (See Value for Manitobans and Reichert 1345)
- It would accomplish case management effectiveness, which would be accomplished through providing staff with tools such as disability duration guidelines and rehabilitation plans built on leading industry practices
  - (See Value for Manitobans, Reichert 1345/1346)
- It would lead to risk reduction to be accomplished by reducing claims leakage over time.
  - (See Value for Manitobans, Reichert 1346)

Where is the Evidence?

- MPI has not demonstrated the BI3 initiative is achieving its promise

BI3 – Times of Dislocation and Turnover

- BI3 implemented September 2010
- Double reserving related to system implementation – resulting in overstatement of certain reserves
  - (addressed November 2012) (Guimond 410 – 413)
- Lag in complying with case reserving guidelines confirmed in March 2013 – gaps in reserving much more extensive than expected

BI3 – Times of Dislocation and Turnover (cont’d)

- Lag in complying with case reserving guidelines identified by actuaries rather than through monthly corporate monitoring
  - (Guimond 413/14)
- Ongoing challenges in managing claims leading to longer than expected duration of files

BI3 – Times of Dislocation and Turnover (cont'd)

- By time of 2012/13 Actuarial Review:
  - We definitely say we have an issue – we have a duration issue and we have a case reserving issue
    - (Johnston, 1360)

What Have We Learned About BI3?

- There have been challenges in adhering to reserving guidelines
- There appear to be some issues with setting reserves per the guidelines that we have
  - (Johnston, 1346)
- There appear to be deviations from existing reserving guidelines on active injury claims (specifically income replacement claims) over the last three fiscal years. Since injury claims from older loss years (i.e. more than three years ago) may still have been active (i.e. open claims receiving IRI payments) during the past three fiscal years, the reserving issues also extend to these claims in some cases.
  - PUB (MPI) 2-15 b)

What Have We Learned About BI3? (cont'd)

- The reserving guidelines challenges involve both older years and more recent years
  - "due to the PIPP reserve review, case reserves for these years [1994 to 2003] were significantly increased something which was not expected."
    - (undertaking 49, p. 1)

What Have We Learned About BI3? (cont'd)

- There was a deterioration in duration performance compared to pre-BI3 benchmarks
  - So clearly the goal of BI3 **isn't to just maintain old benchmarks**, like -- or maintain things the way they -- they were.
    - (Johnston 1362/1363) (emphasis added)
  - But what we're doing is we're putting the benchmarks based on the way that I see them for financial reporting purposes, and we're starting to track the performance relative to those benchmarks **based on pre-BI3 experience**. So at least at a minimum, from an actuarial basis, we -- you know, we can target to meet and then exceed those benchmarks.
    - (1363) (emphasis added) (see also Johnston, 1366)

What have we learned about BI3?

- The decline in performance compared to pre-BI3 benchmarks was costing money
  - But from my perspective on it, I'd be saying, You're **paying a lot more money**, you know. Like, Why are -- you know, why are you still paying these claims, et cetera?
    - (Johnston, 1364)
    - See also MPI Exhibit 58, Undertaking 44

CAC Manitoba Conclusions With Regard to BI3

- While there is still opportunity for improvement:
  - Credibility of case reserves for AB WI – put into question by material disruption occasioned by BI3;
  - Concern relating to management systems – put into question by failure of monthly reporting to identify material lag issue

CAC Manitoba Conclusions With Regard to BI3 (cont'd)

- While there is still opportunity for improvement:
  - Credibility of assertions regarding prudence and reasonableness of costs put into question by challenges experienced in managing duration limits associated with PIPP claims
  - Credibility of claims that BI3 initiative has already demonstrated Corporation control over claims costs in fatally undermined
  - Need for examination of what is going on with management of PIPP reserves
  - MPI has not demonstrated value for money with regard to BI3

No Independent Review Contemplated

- MR. BYRON WILLIAMS: And I take it that it would be correct to suggest that that review will be done by an external party?
- MS. HEATHER REICHERT: No. Post- implementation reviews are done internally with staff that were not involved in the -- in the project itself.
  - (1275)

Is MPI acting in a matter consistent with a Corporation that has lost $133 M over the past two years?

- Significantly higher than peer average IT FTEs
- FTEs as percentage of labour force 17% (internal and external)compared to 11% for peers
  - (Reichert, 1515)
- Definitely shows that MPI has a higher proportion of external consultants in our overall FTE complement, as calculated by -- by Gartner.
  - (Reichert, 1517)

External Consultants Appear Untouchable

- 2014/15 External Consultants
  - 100 – 140 FTE
  - Consulting fees $30.6 M
- Would it be fair to say that if we were to compare the actuals for the 2012/'13 year [around $18 M] versus the budget for 2014/'15, there would be about a $12 million difference?
- MR. DAN GUIMOND: Yes.
  - (435/436)

[see also CAC 1-55 2015/16 GRA and CAC 1-14 (2014/15 GRA)]

External Consultants Appear Untouchable (cont'd)

- MR. BYRON WILLIAMS: So in terms of the straightened (sic) financial circumstances that the Corporation finds it in in the 2014/'15 year, . . . would it be correct to suggest to you that the budget here for external consultants has not changed?
- MR. DAN GUIMOND: Yeah, <u>we won't change the budget.</u>
    - (436) [emphasis added]
- **The Response of MPI is difficult to fathom for the Manitoba Consumers represented by CAC Manitoba**

Not a lot of Evidence of Cost Control

- Operating expenses 13/'14 year almost $68 million.
  - (MPI 437)
- 14/15 forecast operating expenses for 73.6 million
- $5.6 million increase or 8% increase
  - (MPI 437)

Not a lot of Evidence of Cost Control (cont'd)

- Consumers do not distinguish between normal and other operating expenses - especially when the corporation cannot demonstrate value for money

What have we Learned about the Collision Repair Industry?

- It is heavily reliant on MPI for revenue with survey respondents indicating almost 85% of their business comes from MPI
  - (CAC 1-7, MNP 18)
- Comparing the sources of collision repair work from 2009 to 2012, overall, there has been a 4% increase in MPI work and a corresponding 4% decrease in other paid work.
  - (MNP 18)

What have we Learned about the Collision Repair Industry? (cont'd)

- Overall average Earnings before interest, taxes, depreciation and amortization (EBITDA) increased from 9.8% to 10.8% of revenue from 2009 to 2011
  - (CAC 1-7, MNP 58)
- EBITDA was less than 5% for shops with lower than $1M in revenues (2010 and 2011)
  - (CAC 1-7, MNP 59)

What have we Learned about the Collision Repair Industry? (cont’d)

- EBITDA was more than 13% for shops with revenue greater than $2 M in 2011
  - (CAC 1-7, MNP 59)
- EBITDA for the Southeast, Southwest and Winnipeg Regions was over 10% in 2011
  - (CAC 1-7, MNP 60)

What have we Learned about the Collision Repair Industry? (cont'd)

- Increasingly complex vehicles means customers will increasingly need to take their vehicles to larger shops qualified to perform their repairs. This can be expected to result in declining business, and fewer sustainable small shops.
  - (CAC 1-7, MNP 79)
- Training activity still remains low in an industry with significant ongoing changes in materials and technology.
- As technology, materials and environmental and safety regulations continue to evolve in the collision repair industry, ongoing training is required to ensure employees are at the forefront of their respective positions.
  - (CAC 1-7, MNP 79) (Transcript 1323/24)

What have we Learned about the Collision Repair Industry? (cont'd)

- The collision repair industry has raised concerns about the adequacy of formalized training such as apprenticeship technical training;
  - (Guimond, 1328/29)
- Respondents indicated an average of 1.8 days training for journeyperson body repairers per year. Journeyperson painters received slightly more with an average of 2 days per year.
  - (CAC 1-7, MNP 79) (Guimond 1323/24);
- Gaps identified are training in estimating and lean production/management.
  - (CAC 1-7, MNP 46) (Guimond, 1324/25) (see also Guimond discussion 1326/27)

What have we Learned about Estimators and Estimating?

- MPI estimators have relatively high training (journeypersons) as compared to MPI adjustors
  - (Reichert 1254)

What have we Learned about Estimators and Estimating? (cont'd)

- MPI has told us it is important to have qualified estimators
- MR. BYRON WILLIAMS: And MPI's point is the program is only as accurate as the information that's entered into it. And it is important that you have an experienced estimator who knows exactly what to look for and what information to input into the computer program, agreed?
- MS. HEATHER REICHERT: Yes.
  - (1251)

What have we Learned about Estimators and Estimating? (cont'd)

- MPI estimators are currently an important mechanism to prevent leakage
- MR. BYRON WILLIAMS: And by leakage, sir, you're referring to the risk that the estimates -- one (1) risk being that estimates could be higher than they would otherwise be with the check of a visit to the service centre?
- MR. DAN GUIMOND: In -- in today's world, we -- we know that we've been able to **manage the leaking** by doing the estimate, like through the – the service centre. that we have right now. I mean, that's an **important process** that we have right now.
  - (458) (emphasis added)

What have we Learned about Estimators and Estimating? (cont'd)

- Estimators in the body repair industry are relatively poorly paid with a reported average salary decline between the MNP 2009 and MNP 2012 study
  - (CAC 1-7, MNP, p. 37)
- Salary for "Estimator/Service Advisor/Customer Service" is reported to have declined from $ 34,277 to $33,026 with calculated implied annual growth of negative 1.2%
  - (CAC 1-7, MNP, p. 37)

What have we Learned about Estimators and Estimating? (cont'd)

- The Repair Industry has criticized MPI estimating suggesting that:
  - Estimates are often inaccurate, requiring supplemental estimates and resultant delays.
  - Policies and procedures are not clearly communicated and are not followed consistently by all claim centres and estimators, resulting in confusion and delays.
    - (CAC 1-7, MNP, p. 33) (See MPI response Guimond, 1311)

What have we Learned about Estimators and Estimating? (cont'd)

- The Repair Industry has criticized MPI estimating suggesting that:
  - The relationship with MPI is seen by many as adversarial, and *based on cost-containment* with little consideration for customer satisfaction.
    - (CAC 1-7, MNP, p. 33) (emphasis added)

What have we Learned about Estimators and Estimating? (cont'd)

- MPI suggests that current process to prevent leakages is not sustainable in the long term
- **I don't think that's -- that's doable on the long run to continue to approve everything, every line item and so on.** That's why we're putting a lot of software with predictive analytics and – and data analysis. And we believe that we have enough data at the shop level that we can come up with key performance indicators that would be built then into the accreditation agreement, and just be able to monitor on a large extent through deviations of -- of -- standard deviations in terms of performance, and have penalties for people that don't stay within the norms of -- of what they have.
  - (Guimond, 1313) (emphasis added)

What have we Learned about Estimators and Estimating? (cont'd)

- To prevent leakage in the future, MPI intends to rely upon **management by exception** and is planning to invest heavily in information technology
  - We have to use more estimator on site but -- but this thing about going back and forth like that and approving everything on the line item, and so on, we don't view that as sustainable on the long run. I mean, we very well put an analytics, more key performance indicators, modify our accreditation agreements, and really focus on – on *management by -- by exception* through the analytics.
    - (Guimond, 1313)

What have we Learned about the Chairperson?

- The Chairperson asks better questions than Mr. Williams:

  - So what should be a four hundred dollar ($400) bill ends up being a twelve hundred dollar ($1,200) bill. We've already gone through that. Now, looking at it from MPI's perspective, how did MPI protect itself against that hap -- happening when you're going to turn the – the key over to the -- to the repair shop to do the estimation?
    - (See also Guimond response, 1319/20)

What have we Learned about Cost Containment/Performance Benchmarking for Collision Repair?

- With respect to Physical Damage Management, the Corporation is tracking new claims reported as well as estimates completed and related metrics. Key performance indicators have yet to be provided.
  - (*Order 151/13*, p. 21)

- In terms of benchmarking, that the Corporation is still in the process of developing metrics in assessing ongoing productivity physical damage…
  - (Reichert, 1285) (PUB 1-63)

What have we Learned about Cost Containment/Performance Benchmarking for Collision Repair? (cont'd)

- MNP has identified opportunities to employ performance measures as a means to control overall claims costs
- Armed with better performance information, shops may be able to improve productivity, profitability and customer satisfaction. Incorporating performance measures may also provide MPI with a means of improving results and **controlling overall claims costs** without impacting industry profitability.
- Development of performance measures also provides an opportunity to develop options such as variable rate models to reward shops that perform well, and control costs in shops with lower quality or productivity.
  - (CAC 1-7, MNP 81) (emphasis added)

What have we Learned about Cost Containment/Performance Benchmarking for Collision Repair? (cont'd)

- MNP suggests there may be opportunities to increase efficiency on "low risk" claims if clear performance measures are developed.

- Increased use of technology and **performance standards** (e.g., appraiser decision returned within a defined time) provides opportunities to improve accuracy, efficiency and cycle times. Enabling shops to conduct estimates on **low-risk claims**, supported by risk-based auditing and **clear performance measures** may also offer significant improvements in cycle times, cost and customer satisfaction
  - (CAC 1-7, MNP 80)

What have we Learned about Cost Containment/Performance Benchmarking for Collision Repair? (cont'd)

- MNP suggests a validated baseline is necessary
  - While the data from the 2009 and 2012 surveys on the amount of time spent is relatively consistent, it is based on somewhat „global‟ estimates of weekly time spent. Selecting a sample of shops to **validate the baseline for each activity**, pilot improved processes and re-evaluate the time requirements after changes have been implemented would provide important information that may enable more reliable evaluation of changes.
    - (CAC 1-7, MNP 80) (emphasis added)
- The average time of three to four hours spent on these processes per repair, **once further validated**, provides a basis on which improvement can be made.
  - (CAC 1-7, MNP 80) (emphasis added)

What have we Learned about Cost Containment/Performance Benchmarking for Collision Repair? (cont'd)

- It is not clear that MPI has accepted the advice to validate the baseline
  - MR. BYRON WILLIAMS: Sir, you'll -- you'll accept, subject to check, that MNP suggested that these were fairly global estimates and that, going forward, it would be useful to select a sample of shops to **validate the baseline for each activity**, being estimating, parts procurement, and account reconciliation. You'll accept that, subject to check, knowing you can refer to page 80 if you feel the need?
  - MR. DAN GUIMOND: Yes.
  - MR. BYRON WILLIAMS: And I take it this was done?
  - MR. DAN GUIMOND: No.
  - MR. BYRON WILLIAMS: Is it in the process of being done, sir?
  - MR. DAN GUIMOND: **No.**
    - (Guimond, 1315) **(emphasis added)**

What have we Learned about Cost Containment/Performance Benchmarking for Collision Repair? (cont'd)

- Ms Reichert suggests that cost containment benchmarks are relatively far away:
  - MS. HEATHER REICHERT: Metrics of that nature, they'll be determined/developed once we have the -- the new physical damage process fully implemented. To do something on an existing system when we know that we're in the process of changing that system, from our perspective it's not a good use of time and resources at this point.
  - MR. BYRON WILLIAMS: So it's years away, Ms. Reichert?
  - MS. HEATHER REICHERT: I would say it's more than a year away, yes.
    - (Reichert, 1287)

What have we Learned about Cost Containment/Performance Benchmarking for Collision Repair? (cont'd)

- Mr. Guimond suggests that preliminary ones are in development
  - MR. DAN GUIMOND: Right now we – we are in the process of developing them [preliminary list of key performance indicators] with the joint working committee.
  - MR. BYRON WILLIAMS: So you'll have a list to be filed with the GRA next -- for next year, sir?
  - MR. DAN GUIMOND: I would say we may have a preliminary one but not a final one . . . [a]nd those KPIs will continually be adjusted based on our findings [in our pilot projects].
    - (1314)

What did MPI Originally tell us about the Projected Savings associated with PDR?

- MPI originally projected annual cost savings of $13 M related to PDR including almost $10 million directly related to reducing claims costs.
  - (PFT.DG.15)

What Have we Learned about the Projected Net Benefits of PDR?

- MR. DAN GUIMOND: We pay for the licensing. That's one (1) of the things we mentioned last week, how our -- out of -- out of the $13.3 million that we're going to save compared to how we do business today. But the new model, we expect we're going to pay $5 million in other costs, being -- one (1) of them being the licensing agreement. I think there's an undertaking that specifies that amount.

- That's why we believe the net savings to ratepayers will be approximately $8 million by the time you're done with, you know, saving compared to what you do today, what it costs tomorrow, but then that bottom line saving is about $8 million.
  - **(Guimond, 1321)**

What Have we Learned about PDR

- There are both potential opportunities but acute vulnerabilities related to an aggressive move to re-envision property damage claims control mechanisms
- As the recent challenges experienced with BI3 demonstrate times of dramatic business transformation may have unintended and unwelcome legacies

What is Less Certain With Regard to Collision Repair Re-engineering?

- Is the MNP vision of delegating the estimation of “low risk” claims to body shop consistent with the Guimond vision of “management by exception”?
- Why does MPI appears considerably less enthusiastic about its cost control benchmarks as compared to MNP?

What we Probably Need to Discuss Especially in the Context of Deductibles?

- What are the tradeoffs for consumers in trying to preserve the smaller shops?
  - Are these shops sustainable?
  - See deductible recommendation

The Consequences of Times of Change and Turnover

- It's just a question of -- of a lot of changes real fast with **a lot of turnover**, and you need to be able to go back from a management perspective to make sure people got it right, that they're doing the right things.
  - (Guimond, 404, context BI3)

- What are times of rapid change doing to morale and staff productivity?

What is Going on With Staff Morale?

- We lack the comfort of recent employee satisfaction surveying with the most recent dating back 2011/12.
- Given significant change in BI3 including Guimond "turnover" comment would have expected MPI would have conducted employee surveys to gauge:
  - response to massive change in BI3
  - forecast change in PDR

Absence of Employee Satisfaction Surveys

- Especially given allegation in Value for Manitobans of increased employee satisfaction related to the bodily injury improvement initiative, or BI3
  - (Reichert,1268)

Absence of Employee Satisfaction Surveys (cont’d)

- MS. HEATHER REICHERT: it's been about three (3) years since an employee satisfaction survey has been completed.
  - (1264)
- Employee opinion survey not conducted 2013/14
  - (Reichert, 1264/65)

Absence of Employee Satisfaction Surveys (cont'd)

- No surveys of satisfaction with, or criticism of :
  - 1) The PIPP's claim handling and reserving process;
  - 2) The collision estimating and reserving practice;
  - 3) The team adjusting process;
  - 4) The physical damage re- engineering process; and
  - 5) Compliance with loss of use policy and expenditure guidelines.
    - (MPI Exhibit 55, see also Reichert 1266)
- Notwithstanding claim of increased employee satisfaction related to BI3, MPI unable to point to a formal opinion survey in that regard
  - (Reichert 1274/75)

Road Safety: Has the new legislative mandate and the advice of Mavis Johnson triggered an energetic response from the Corporation?

The New Mandate

- s. 6(2) (H) amended
- "The legislation will also help MPI to be more proactive in helping prevent accidents that have a cost for all."
  - CAC Exhibit 12, p. 53 comments of former Minister Swan

The CAC Manitoba Understanding of the Advice of Mavis Johnson

- An evidence based, integrated road safety strategy can have a meaningful effect in reducing the tragic social and economic costs of accidents
- You can and have to evaluate cost effectiveness both economically and socially
  - as programs
  - as part of portfolio
  - as part of integrated approach

CAC Manitoba has no Doubt that MPI will have Challenges in Justifying the Utility of its Road Safety Expenditures

- That does not mean that a more carefully, constructed evidence based program could not be optimized and justified

The Driver Education Program Continues to Face Many Challenges

- to-date, evaluations have not demonstrated that driver education programming to-date is producing safer drivers
  - (1523/24 Reichert)
- AAA Foundation for Traffic Safety "Evaluation of Beginner Driver Education Programs."
  - (1522)
- MR. BYRON WILLIAMS: So unlike the analysis conducted in Oregon, the MPI high school driver education program was not assessed in terms of its performance in terms of collisions, convictions, and suspensions, agreed?
- MS. HEATHER REICHERT: Yes.
  - (Reichert 1525)

The Driver Education Program Continues to Face Many Challenges (cont'd)

- There was no significant difference in the past rates for the Manitoba students who took high school driver's ed. versus the non-driver's ed. Group
  - (Reichert, 1529)
- Manitoba driver's ed. Students with an intermediate licence still showed a significantly higher rating of their self-reported driving skills which might, suggest they overestimate their actual skill levels
  - MPI 17, p. 8 (1529)

See Recommendations

Prudent and Reasonable Management

- MPI has failed to demonstrate that its management of interest rate risk is prudent and reasonable.

Does an Insurance Company Bet?

- MS. HEATHER REICHERT: As an insurance company I can say that MPI doesn't bet.
  - (Reichert, 1409)

Core Message of CAC Manitoba Regarding Asset Liability Matching

- Since 2010, it would appear that MPI has had a history of placing losing bets on duration mismatches and interest rate risk
- The evidence of MPI appears to suggest that the losing 2010 bet cost MPI ratepayers a significant sum of money
- MPI appears to be still betting on interest rate duration mismatches notwithstanding the evidence of its CEO that he does not expect interest rates to rise in the near term
- Basic ratepayers are disproportionately exposed to a declining interest rate scenario given the longer duration of basic liabilities

Betting on an Interest Rate Rise

- MPI going to a two (2) year band in 2010 had the effect of increasing interest rate risk
  - (1406)
- And among the factors MPI has given for choosing to move to a two (2) year band in 2010 was the expectation that interest rates were forecasted to increase
  - (1406/1407) (CAC 1-146 f)
- By moving to a two (2) year bandwidth, MPI was betting that interest rate would rise
- They were betting and without the benefit of a robust financial model that could forecast bottom line impacts

Betting on the Interest Rate Rise in 2010 Cost Ratepayers a lot of Money

- even back in 20 -- 2009, 2010, interest rates were forecasted to increase, and they actually in fact decreased. that **absolutely negatively impacted the net income** of MPI in those years.
  - (Reichert 1416/1417) (emphasis added)
- So the only reason that over all those years did not end up in being in **massive negative positions** was that it was at that same time that the twelve dollars ($12) per policy per year that was being collected as it related to the implementation of the PIPP program
  - (Reichert 1416/1417)

Betting on the Interest Rate Rise in 2010 Cost Ratepayers a lot of Money (cont'd)

- So at the same time that we were seeing significant impact from interest rates not increasing as expected, that was the same time that we were in fact also seeing releases of claim reserves. So the **net impact** to the Corporation, as was described last year, was in fact **masked** between those two (2) events.
  - (Reichert, 1417) (emphasis added)

Basic is Disproportionately Exposed

- Basic to the Corporation as a – as a whole, would it be fair to say that Basic is relatively over-exposed to downside duration risk as compared to the portfolio as a whole?

- MR. LUKE JOHNSTON: Well, the gap is -- the gap is -- it's a fact -- it's a fact that the gap is bigger. **So in that case, the -- the mismatch will be bigger.**
    - (1399) (emphasis added)

Basic is Disproportionately Exposed (cont'd)

- We generally expect that the average duration of claims liabilities for Basic will be somewhat longer than the average duration of claims liabilities for the Corporation as a whole
  - (Johnston 1398/99)
- 8.9 years corporate
  - (Johnston 1397)
- 9.8 years basic
  - (MPI 61)

Exposure Risk is Exacerbated if MPI Does Not Adhere to Bandwidth Guidelines

- The results of CAC 3-23 and CAC 1-146 g) demonstrate circumstances where MPI has failed to adhere to the bandwidth guidelines
  - (see also Reichert 1421)

Ms Reichert Initially Mistakenly Characterized the Non Adherence to the Bandwidth Guidelines as a Forecasting Issue

- The more fundamental concern is risk mitigation

Are Forecasts Reasonably Reliable?

- **Core Messages**
  - Consumer understanding and the rate setting process has been hindered by the lack of transparency in the MPI approach
  - The investment income forecast underlying the rate application is not reasonably reliable in that:
    - it fails to employ the most current consensus forecast of interest rate risk which represents a material change from the March consensus forecast
    - based on historic performance over the last five years and current unrealized gains in the portfolio there are grounds for concern that the overall forecast of investment income for 2014/15 and 2015/16 is understated

Are Forecasts Reasonably Reliable? (cont'd)

- **Core Messages**
  - There are reasonable grounds for concern that the PIPP claims costs (particularly AB WI and AB Other) are overstated given the material increase in case reserves and the trends selected
  - There is some uncertainty related to the reliability of collision severity and collision costs given the change in forecast methodology and the unusual claims processing challenges in the winter of 2013/14

An Opaque Approach

- MR. BYRON WILLIAMS: So leaving aside questions related to the RSR, and focusing specifically on the objective of breaking even for the 2015/'16 fiscal year, it would be accurate to say that you are suggesting MPI needs a rate increase, a general rate increase, of 3.5 percent to break even.
- MR. DAN GUIMOND: No.
  - (395/396)

An Opaque Approach (cont'd)

- MR. BYRON WILLIAMS: And recognizing that your -- that MPI is not seeking to vary its application, if my client were to ask MPI's advice on the rate increase, am I correct in inferring that MPI would advice CAC that a 3.4 percent rate increase was desirable?
- MS. HEATHER REICHERT: Yes.
  - (Reichert 1460)

Ratepayers Deserve Better

- They deserve clarity in terms of the best advice of the corporation

How Did MPI Respond to the Open Door on Interest Rate Methodology?

- CAC Manitoba interprets last year's board order as leaving the door open for MPI to revisit the interest methodology issue with better information

- MPI does not appear to have taken advantage of that opportunity:
  - Given your discomfort with the interest rate forecasting, did you seek external expertise? Someone with an expertise in finance, for example, to assist you in revising your model for projecting interest rates?
    - (438)
  - in the time period between the Board order in the last year's general rate application and today, did you seek external expertise to assist your Corporation in refining your interest rate forecast? . . .
  - MR. DAN GUIMOND: No.
    - (439)

There Would Appear to be Consensus That Employing a More Current Forecast Significantly Different From the Earlier Forecast is Good Practice

- This is consistent with CAC Manitoba position in a series of Centra and Hydro hearings dating back to 2009
- The PUB has adopted this approach in prior Centra Board Orders

There Would Appear to be Consensus That Employing a More Current Forecast Significantly Different From the Earlier Forecast is Good Practice (cont'd)

- MR. LUKE JOHNSTON: it's hard for me to say that a more recent forecast is not better information. It is, right. . . . So from an interest rate perspective only, I do believe that that's a more relevant forecast for the Board's consideration.
  - (1458, Johnston)

- MPI in general agreement with the concept that if there is a material change from a forecast that was used for the rate application to a more updated forecast, that that should be an important factor in the Board's deliberations for the purposes of rate setting
  - (Johnston, 1458)

Overarching Concern with the Investment Income Forecast

- Issue of volatility of investment income longstanding interest of PUB
- In Order 145/10, the Public Utilities Board recommended that:
  - "MPI consider the use of 5 year averaging, to reduce the annual rate and net income risks that come with increased volatility within the investment market, and report to the Board on this suggestion at the next GRA".

The Investment Income Forecast Does Not Pass the Eyeball Test

- Volume II, Investment Income, p. 5
- Viewed very simplistically, investment income forecast does not pass the eyeball test
- The eyeballs became even more strained when one reviews the second quarter report and the reported unrealized gains

The Investment Income Forecast Does Not Pass the Eyeball Test (cont'd)

- Total Investment Income has ranged from $83 million to $172 million and has averaged around $114 million. (97 M basic)
- Current year and test year range $59.5 M total to 84.4 M total average about $72 M
- Average basic $39 M
- It stretches credibility that in the next two years (with similar forecasts of rising interest rates), MPI expects to average only $72 M

It is Challenging to Make Sense of MPI's Evidence With Regard to PIPP Claims

- We know that the stresses associated with BI3 have led to:
  - a lag issue related to the timely posting of claims reserves in a manner consistent with guidelines

It is Challenging to Make Sense of MPI's Evidence With Regard to PIPP Claims (cont'd)

- We know that the stresses associated with BI3 have led to:
  - challenges in managing duration exposure with MPI performing unfavourably compared to pre BI3 benchmark in the years 2008/09 through 2013/14
    - (MPI 58)

It is Challenging to Make Sense of MPI's Evidence With Regard to PIPP Claims (cont'd)

- We know that:
  - if nothing else has changed in how we handling . . . claimants other than the timing of when the reserve is posted, then your exposure hasn't really changed
    - (Johnston 1354)

It is Challenging to Make Sense of MPI's Evidence With Regard to PIPP Claims (cont'd)

- We know that MPI indicates that
  - what the reality was, where we had kind of both things going on [both a timing issue and a duration exposure issue]
    - (Johnston 1354)

It is Challenging to Make Sense of MPI's Evidence With Regard to PIPP Claims (cont'd)

- But then MPI tells us:
  - The actuarial report (ie historical ultimate loss estimates) and the Corporation's PIPP claims forecast have been prepared on the assumption that PIPP claims experience will return to historical patterns (ie we have not assumed that the deterioration of results relative to benchmarks experienced after BI3 implementation will continue into the forecast period.)
    - (MPI 59, p. 4)

It is Challenging to Make Sense of MPI's Evidence With Regard to PIPP Claims (cont'd)

- The dilemma posed by the MPI evidence is that if case reserves go up then IBNR should go down
  - Every dollar into case reserves should be a dollar out of IBNR
- MPI seems to be saying the increase in case reserves does not bring down IBNR
- So the ultimates were wrong
- Our client and its advisors continue to be perplexed

It is Challenging to Make Sense of MPI's Evidence With Regard to PIPP Claims (cont'd)

- Factually, has been significant development in case reserves which suggests that data used to establish loss development factors in recent years is not reflective of experience
- Experience does not reflect current guideline

Given the cloudy data engendered by the stresses in BI3

- One option is to restate the data using the correct guidelines then carry on selecting loss development factors as usual. This might have been the best approach
- Another option is to assume development will be the same as history once the case reserves are adjusted

It is Challenging to Make Sense of MPI's Evidence With Regard to PIPP Claims (cont'd)

- It appears
  - They are moving incurred more quickly towards ultimate but not reflecting those change in ultimates

Collision Severity - Core Issues

- The collision claims forecast is clouded by the change in forecasting methodology and the challenge of disentangling the adverse consequences of a bad winter from apparent higher severity costs
- On the other hand, there appears to be additional adverse development in the collision IBNR (as of September 2014)

Collision Severity - Core Issues (cont'd)

- The "double reserving" on the collision side in the winter of 2013/14 related to the rollout of the new Mitchell product is illustrative of stresses within the organization related to the rollout of new information technology products
- Allegations of a high loss impact in the corporation's collision future appear to be of limited relevance for the current GRA

Collision – Double Reserving Winter 2013/14

Change in Claims Forecasting Process

- MR. BYRON WILLIAMS: And am I correct in suggesting that the repair rate growth factor's analysis was not used to create this year's collision or comprehensive forecast?
- MR. LUKE JOHNSTON: Yes.
  - (1371/1372)
- Of course, the year we did that we had 10 percent severity increase. So the timing wasn't the greatest.
  - (Johnston, 1373)

Collision Severity Additional IBNR

- Additional hit on collision severity over and above the IBNR
  - (1337/38)
- I do happen to have the September month-end claims information on my computer.
- your question about collision, as of end of September we had budgeted to have 13.6 million reported. [We]actually had 18.3 million reported from prior years. So we were about 4.7 million over budget at that time.
  - (1340)

Double Reserving on the Collision Side

- Was related to a systems issue that resulted in an overstatement of reserves.
  - (1277/78) (Pub 1-52 a)

Collision Long Term Trends

- Preliminary analysis is based on a sample of 22 three (3) vehicles, being a 2014 Lexus, an 2013
  - (MPI Exhibit 18)
- 23 Equinox, and a 2014 Ford Edge
  - (1346 – Reichert)
- Not a forecast
  - (1347)
- Projections here are simply indicative of a trend that should be monitored.
  - (Reichert 1348)

Collision Long Term Trends (cont'd)

- Significant part of the repair mix in the 2020 to 2021 time frame
  - (Reichert 1348)
- Cost impacts have not been incorporated into the current forecast as mechanism will take time to develop.
  - (MPI Exhibit 18)

Positive Future Trends Relating to Collision

- As these safer vehicles make up a larger percentage of the vehicle fleet, it will ultimately lead to a reduction in claims and claims costs.
  - (MPI Exhibit 37)
- Safer vehicles being autonomous cars that basically drive themselves, and what the industry is showing, that the only instance I guess where an autonomous car has been involved in a -- in a collision was when the driver actually took over and overrode the autonomy of the car, if you will.
- Longer term
  - (Reichert 1442, 1443)

Longer Term Trend in Reducing Collisions

- Autonomous cars, actually, are preventing physical damage, because they are avoiding collisions altogether. So it is with respect to impact on physical damage repair costs that I was referring,
  - (Reichert, 1446)

Are the Reserves Reasonably Set? Core Messages

- Fatigue has set in – we all want the issue done but evidence of good faith efforts and some of challenges – transitioning DCAT tool and mindset to RSR purpose
- Lack of clarity for consumers relating to purpose and use of RSR – it does not seem to mean what consumers might think it means
  - (see also CAA comments)

Are the Reserves Reasonably Set? Core Messages (cont'd)

- CAC Manitoba sees excessive RSR as invitation to overspend – to bet on duration mismatch or to fund expensive IT programs
- CAC Manitoba did not receive the assurance it was seeking from MPI on this point

Are the Reserves Reasonably Set? Core Messages (cont'd)

- CAC Manitoba does not accept the characterization of 1/40 as consistent with consumer risk tolerances – believes a range of 1/20 to 1/40 is more appropriate
- CAC Manitoba understands the substantial judgment underlying interest rate and combined scenario. It does not accept characterization as 1/40 events

What are the Rules to Protect Consumers From MPI Using the RSR For a Different Purpose?

- Spent five pages trying to get assurance for customers
- Would I be correct in suggesting to you that the funds within that target range should not be used for any purpose other than protecting against unforeseen extreme events?
  - (447)
  - (lengthy discussion follows)
- What I'm asking you, if -- if we achieve an RSR level, in your opinion is it appropriate to draw down the RSR level to invest in capital projects for the Corporation?
  - (449)
  - (lengthy discussion)

Looking for Assurance

- MR. BYRON WILLIAMS: And you can understand the concern of consumers that reserves at a certain level may pro -- promote a desire by the Corporation to avoid putting costs into the rate base and to subsidize imprudent expenditures through their reserve. You can understand that policy concern from consumers?
- MR. DAN GUIMOND: Yes.
- MR. BYRON WILLIAMS: And so on behalf of my client, I'm asking you for what safeguards there are for consumers that the next time an IT project comes along that catches the fancy of the Corporation, it won't be funded out of funds designated for a specific purpose?
  - (BRIEF PAUSE)
- MR. DAN GUIMOND: The only thing I can say is that the RSR is to be used as agreed to in terms of definition as been agreed here for many, many years and that, if, for whatever reason, in the future there would be something that would be done differently or hypothetically or whatever, I think it'll -- it'll be handled at that point in time. But -- but the RSR is per what -- what the definition is.
  - (450/451)

IT Optimization – Moral Hazard

- IT optimization fund, and a withdrawal of $65 million associated with it in the 2010/'11 year.
  - (Johnston 1460)
- A decision to segregate a certain fund in retained earnings as a placemark for funds that might be required over time with respect to the information technology optimization.
  - (1461/1462, Johnston) (Order 162/11, page 59)

Concern With Leaving Corporation Too Comfortable to Make Higher Risk Expenditures

- To engage in major IT expenditures or to dramatically increase operating expenses knowing that you have the backing of substantial retained earnings

Will the RSR Encourage Corporation to Engage in Riskier behaviour?

- MPI CEO has expressed his opinion that interest rates are not going up in the short term
- The only thing I'm saying is that I don't agree that interest rates are going to go up.
  - (Guimond 397)
- We -- and it's very possible that -- that the interest rate will go up, or not, or whatever. I don't think they're going to go up.
  - (Guimond 397)

Will the RSR Encourage Corporation to Engage in Riskier behaviour? (cont'd)

- Yet continues to support an interest rate mismatch where mitigation options appear open

Immunizing Customers From Volatility

- do you recall using words to the effect that, We really have to immunize our customers from that volatility?
- MR. DAN GUIMOND: Yes. Financial volatility.
  - (444)
- MR. BYRON WILLIAMS: So, sir, in terms . . . of that volatility . . that you see . . . what we have to immunize consumers from, that would be restricted to the $16 million effects of the extreme winter. Is that correct?
  - (445/446)
- MR. DAN GUIMOND: From my perspective, it's unforeseen events plus things that happen that -- 6 that you didn't foresee. So I wouldn't limit it to the $16 million.
- MR. BYRON WILLIAMS: Well, do you see the RSR is -- using that as an example, is protecting us from all $104 million, sir?
- MR. DAN GUIMOND: That could be an example, yes.
  - (446)

Amending Answer Regarding Protecting Against Volatility

- MR. BYRON WILLIAMS: And to go back to the example of the $104 million variation, would I be correct in suggesting that you wish to amend your previous answer, and restrict it to protecting against the $16 million extreme winter event.
- MR. DAN GUIMOND: To make it consistent with the definition that I provided.
  - (447)

Should be Understood as CMMG Will Attest That the RSR Will Not Immunize Ratepayers From a Primary Source of Immunity

- Not overall rate increase
- But CLEAR related or DSR related adjustments

Does the RSR Mean What We Think it Means?

- Is the RSR just another word for retained earnings?
- If the RSR is there for unforeseen non-recurring events – why is it drawn down for other purposes (ie ordinary losses relating to inflationary trends)
- Is the RSR surcharge guaranteed to contribute to the RSR?
- Not unless the corporation enjoys net income in that particular year
- If the Corporation breaks even or loses money the RSR is not replenished by a surcharge

Can We Eely on DCAT to Set a Reasonable RSR Range at the 1/20 and 1/40 Confidence Levels?

Challenges with the Interest Rate and Combined Scenario

- Three analytical challenges
  - **zero lower bound of nominal interest rate -** renders both the data and the distribution developed from the data of little or no value
  - the methodology used to select the floor was based on a bad month or a bad day which does not support a four year floor
  - a negative yield floor or neutral yield floor is not sustainable for four years in the North American marketplace

Challenges with the Interest Rate and Combined Scenario (cont'd)

- One contextual
  - a four year floor at negative real yields is inconsistent with developments in the North American including the end to quantitative easing and the recovery of the US marketplace

The Zero Lower Bound

- There is a lower bound on interest rates, essentially a . . .lower bound of zero or slightly more than zero
- As an asset, cash has a return of zero, and that if interest rates were, in fact, at zero, everybody would hold cash and nobody would buy bonds and nobody would issue1 bonds, which would lead to both monetary policy ineffectiveness and essentially a collapse of the financial system as we know it.
  - (Simpson 1638/39)
- If cash gets you zero, you're not going to take minus 1 percent to hold bonds.
  - (Simpson 1640)

The Stagflation Data Problem

- The big problem is that all of the interest rate declines that are found in the DCAT report looking at the period from '56 to today are adverse scenarios that occurred during one (1) period **of very high interest rates between '76 and '85.**
  - (Simpson 1641) (emphasis added)

- That is to say, it has adopted inflation targeting procedures which causes the Bank of Canada to lean against the wind of inflation once it gets near the top of that band of 3 percent. And that was not the case earlier, and I think monetary policy has learned from that period, because that was a worldwide phenomenon and a worldwide lesson, that if it's a choice between high inflation and low inflation, you're not going to get very much out of that in terms of improved economic performance, and so you're better off **to adopt a low inflation strategy.**
  - (Simpson, 1643) (emphasis added)

Exaggerated Interest Rate Declines

- And this is just a way of saying that I think the reliance on the great stagflation exaggerates the kinds of interest rate declines that we might -- might see.
  - (Simpson, 1646)

The Stagflation Problem

- Prior to Bank of Canada targeting which MPI admits in its DCAT has created a structural break in inflation results
  - (Johnston, 1473/1474)

Mr. Johnston Agrees With Dr. Simpson on the Zero Lower Bound

- We work under that presumption that nominal interest rates **cannot fall below zero** given the understanding that rational agents would not purchase an asset yielding a negative return when they could hold currency at a zero rate of return
  - (Johnston, 1475)
- With nominal interest rates below zero, cash would become a more attractive option
  - (Johnston, 1475)
- Bank of Canada has clearly stated that it considers twenty-five (25) basis points to be the effective lower bound for its overnight target rate
  - (Johnston, 1476)

The Selection of the Floor

- Essentially, what the DCAT report does is it plucks a single monthly Government of Canada ten (10) year bond yield, the smallest one in the series, which I think is July 2012.
- But I also looked at what it was for -- for that year, it was 1.85 percent, and what it was for four (4) years. It was 2.53 percent.
- Now, if you said, What is the minimum floor that you would get to over a four (4) year horizon, because in these DCAT scenarios you're getting to the floor immediately and it's staying there for four (4) years, it seems to me you'd be more appropriate to use a four (4) year floor than a -- than a one (1) month floor and projecting it out over four 4) years.
  - (Simpson, 1647)

Negative Yields

- DR. WAYNE SIMPSON: Well, you know, inflation is a benchmark, and just as there's a lower bound (sic) on nominal yields, there's some degree of boundaries on negative real interest yields -- that is, interest rate yields that are lower than the rate of inflation, not at the policy end, you know, the overnight bank lending rates, but certainly in the case of -- of lenders and borrowers.

- You take, for example, mortgage rates. You say, What's the lower limit on mortgage rates? Well, if -- if they are below the rate of inflation, then the mortgage lenders are not doing as well as presumably -- they're not even keeping up with increases in their costs.

- And what is likely to happen then is -- is they're either going to find alternative investment instruments, alternative equities, bonds, and so on that would offer them a better return is -- is their likely response.
  - (Simpson 1773/1774)

The MPI Duration Matching Report Offers Support to Dr. Simpson

- Duration matching paper:
  - Then a ten 10) year bond purchased on this date and yielding 1.7 percent would have a negative yield of 0.3 percent on an annual basis over this period, all other things being equal
    - (Johnston, 1477)

Mr. Johnston and Negative Yield

- Repeatedly decline to answer:
  - in circumstances of negative yield, would you agree with the proposition that it would be reasonable to assume the probability of interest rates increasing, is much higher than the probability of interest rates falling
    - (Johnston, 1477, 1478, 1479)
- I see your point that there's a lot-- a lot of territory that interest rates could go on the upside and not so much on the downside.
  - (Johnston, 1480)

End of Quantitative Easing - CAC 19

- In light of uneven global recovery, monetary policies may diverge further across regions in the period ahead. After aggressively expanding its balance sheet, UA Federal Reserve is expected to announce the end of its asset purchase in October. In contrast, the Bank of Japan is continuing to expand its balance sheet, and the European Central Bank (ECB) undertook further actions in September to support economic growth in the euro area. Market expectations for future policy rates imply different paths for monetary policy across regions. (4)
- Chart 6

The Combined Scenario Flounders Under Poor Data and the Flaws in Selecting the Floor

- I find this problematic in the same sense that I find the interest rate decline scenario problematic in the sense that they rest on interest rate declines from the great stagflation that I don't think has any relevance to the current circumstances.

- And They [are based] on a floor, which I think is -- is also questionable as a -- as a basis for thinking about where interest rates might, in the worst of all **possible worlds, go and stay.**
  - (Simpson, 1648) (emphasis added)

CAC Manitoba Team Simpson

- Simpson - Evidence based analysis using good modern risk assessment
- Expert applied econometrics, applied microeconomics, Bank of Canada, Economic Council of Canada Centre for study of inflation and productivity
  - (Simpson, 1616)
- Evidence based risk analysis for Crowns

CAC Manitoba Team Sherry

- Ms. Sherry's response is as follows. "It is my opinion that the DCAT could be a superior methodology than the Kopstein methodology to calculate a RSR range. However, I agree with Dr. Simpson's recommendation that the Kopstein methodology continue to be used until such time as 1. The DCAT exercise can be used to establish an appropriate range for the RSR rather than a target and 2. The apparent issues with the chosen adverse scenarios are worked through."
  - (MPI (CAC) 1)

Final Rate Commentary

- Less than 3.5
  - PIPP, Investment Income, Cost Control
- 2.75
  - no RSR surcharge

Recommendations

Thank you for your consideration