

Response to MPI IRs on Simpson Report on DCAT and RSR

MPI (CAC) 1

Professor Simpson concluded that the size of the Rate Stabilization Reserve (which has the stated purpose "...to protect motorists from rate increases made necessary by unexpected events and losses arising from nonrecurring events or factors.") should be established using the Kopstein methodology. Is it the professional actuarial opinion of Ms Andrea Sherry, who provided advice and assistance in the preparation of Professor Simpson's report, that the Kopstein methodology is a better methodology than DCAT to calculate the minimum Rate Stabilization Reserve?

Response:

CAC MB notes that while Dr. Simpson benefited from the advice of Ms Sherry and Mr. Dyck, he is solely responsible for the evidence in his report. Dr. Simpson cannot speak for Ms Sherry either in written information responses or in oral testimony. While CAC MB is under no obligation to provide Ms Sherry's views, it is prepared to provide this information both as a courtesy and because they believe it might assist in the panel's deliberations.

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) 2

a) Will Ms. Andrea Sherry, who provided advice and assistance in the preparation of Professor Simpson's report, list the concerns she raised at the DCAT Technical Conferences that in her professional actuarial opinion, prevent the DCAT from being used as the methodology to determine the size of the Rate Stabilization Reserve?

Response:

CAC MB notes that while Dr. Simpson benefited from the advice of Ms Sherry and Mr. Dyck, he is solely responsible for the evidence in his report. Dr. Simpson cannot speak for Ms Sherry either in written information responses or in oral testimony.

CAC MB notes the DCAT Technical Conference of this spring (2014) was intended to be a without prejudice discussion in order to facilitate the dialogue and mutual learning experience. CAC MB understands that MPI implicitly has waived the without prejudice agreement by posing this question. While CAC MB is under no obligation to provide Ms Sherry's response, it has done so as a matter of courtesy.

Ms. Sherry's response is as follows. "The DCAT technical conference that I attended focused on how the DCAT model works. We did not have the 2015 GRA at that time in order to review the adverse scenarios chosen nor did we discuss the need for a RSR range. We also did not discuss the use of the MCT to set the upper end of the RSR target range."

b) Will Ms. Andrea Sherry, who provided advice and assistance in the preparation of Professor Simpson's report, list the improvements she suggested at the DCAT Technical Conferences to address lack of transparency concerns expressed by Professor Simpson about the DCAT methodology?

Response:

CAC MB notes the DCAT Technical Conference of this spring (2014) was intended to be a without prejudice discussion in order to facilitate the dialogue and mutual learning experience. CAC MB understands that MPI implicitly has waived the without prejudice agreement by posing this question. While CAC MB is under no obligation to provide Ms Sherry's response, it has done so as a matter of courtesy.

Ms. Sherry's response is as follows. "I have requested access to MPI's DCAT model in Excel format so that the formulas could be followed and understood. This request was denied. We did not provide a list of improvements at the DCAT Technical Conference. The information provided at the conference was used to build a premium and loss forecast model in Excel that confirmed the model seemed to be working appropriately using the Corporation's base scenario assumptions. However, we did not have the 2015 GRA at the time of the Conference in order to review the adverse scenarios chosen nor did we discuss the need for a RSR range and the use of the MCT to set the upper end of the RSR target range."

c) Is it the professional actuarial opinion of Ms. Andrea Sherry, who provided advice and assistance in the preparation of Professor Simpson's report, that the MCT is an arbitrary methodology for assessing risk for a property and casualty insurer's adequate capital level?

Response:

Mr. Simpson's response to this question is provided in PUB/CAC I-1(b).

CAC MB notes that while Dr. Simpson benefited from the advice of Ms Sherry and Mr. Dyck, he is solely responsible for the evidence in his report. Dr. Simpson cannot speak for Ms Sherry either in written information responses or in oral testimony. While CAC MB is under no obligation to provide Ms Sherry's views, it is prepared to provide this information both as a courtesy and because they believe it might assist in the panel's deliberations.

Ms. Sherry's response is as follows. "The MCT is an attempt to determine risk based capital requirements for private P&C insurance companies in Canada to ensure their future solvency. Private companies, particularly mutual companies, do not have access to cash from outside sources so need a capital reserve to ensure they can withstand emerging risks. This is a very different situation from a public monopoly with access to government or tax payer's funds. The MCT itself is not an arbitrary methodology but MPI's choice of a certain MCT level to use as the maximum for the RSR target range is arbitrary at this point. There is no analysis behind the suggested level."

MPI (CAC) 3

At page 8 of his report, Professor Simpson rejected the use of MCT in establishing the size of the RSR by stating:

"Consequently, any target for the MCT, whether 100% or 50% or some other number, remains arbitrary and particularly so in the context of the assessment of risks facing MPI and an appropriate target or range for the RSR."

Can he explain why the following similar statement should not be used in describing the Kopstein methodology:

Consequently, any range for the Kopstein methodology, whether 10% or 20% or some other number, remains arbitrary and particularly so in the context of the assessment of risks facing MPI and an appropriate target or range for the RSR.

Response:

The Kopstein methodology is also arbitrary, which I have never denied, but it has the advantages of transparency, simplicity, stability and incumbency compared to the DCAT methodology.

MPI (CAC) 4

Preamble: The Corporation has filed approximately 3000 pages of evidence related to DCAT and has attended the DCAT Technical Conferences to discuss issues and receive input related to DCAT from the Board advisors and Interveners.

Professor Simpson has criticized the DCAT methodology for its lack of transparency. What would Professor Simpson suggest the Corporation could do to improve transparency so that it will be an acceptable tool for determining the size of the Rate Stabilization Reserve?

Response:

My criticism of the lack of transparency in the DCAT methodology in this report actually refers to the previous report written prior to the DCAT technical conference and recent evidence related to the DCAT. I noted that a good example of the value of transparency was the discussion of the decline in equities scenario in my earlier report, which identified the problems associated with the use of data from the Great Depression of the 1930s to assess risk in the modern economy. I noted that the current DCAT report has corrected this flaw by using only data since 1955 to assess the decline in equities risk. Another comparable example in my current report is the interest rate decline scenario, which I believe overstates the risk associated with interest rate decline by including data from the Great Stagflation of the late 70s and early 80s in the analysis. Further improvement in transparency might also be realized by arrangements which would allow access to the DCAT modelling.

MPI (CAC) 5

Please advise which, if any, parts of Professor Simpson's Report were written by Mr. Peter Dyck or Ms. Andrea Sherry.

Response:

I wrote the report in its entirety and am responsible for its contents. Ms. Sherry and Mr. Dyck reviewed the report.

MPI (CAC) 6

Preamble: Professor Simpson indicates at page 8 of his report: "The issues associated with the usefulness of the MCT in the context of monopoly Crown Corporation have not been resolved".

a) Please confirm that SGI and ICBC seem to have resolved this issue since they have utilized MCT since 2007 and 2003 respectively;

Response:

Adoption of the MCT would not necessarily imply that the “issues associated with the usefulness of the MCT in the context of a monopoly Crown Corporation” have been resolved.

b) Please confirm that SGI, the crown corporation monopoly, utilizes an MCT of 100% to calculate its minimum rate stabilization reserve;

Response:

This is my understanding, yes.

c) Please confirm that ICBC, the crown corporation monopoly, utilizes an MCT of 130% to calculate its minimum rate stabilization reserve.

Response:

Yes.

MPI (CAC) 7

a) What is Professor Simpson’s understanding of why changes in interest rates create a forecasting risk for the Corporation?

Response:

The base scenario uses a consensus forecast of rising interest rates. If interest rates do not rise as fast as the consensus forecast, or actually fall, it will affect bond returns in the investment portfolio. MPI also indicates that it now uses the projected interest rates from the investment model (i.e. interest rate changes in the adverse scenarios) to calculate its actuarial liabilities.

b) What is Professor Simpson’s opinion on the reasonableness of the current interest rate forecasts from the major banks?

Response:

The major banks would be among the best sources of interest rate forecasts in Canada.

c) What is Professor Simpson’s opinion on the likelihood of interest rates remaining near current levels for the next 1, 2, 3, and 4 years?

Response:

As the interest rate forecast in the base scenario suggests, the consensus among economists is that interest rates will rise over the next four years as the economy nears its growth potential. I would agree with this assessment and rate the likelihood of interest rates remaining near current levels for the next one to four years as low. I would rate the likelihood of interest rates falling more than 1.5% more from their current low levels and staying there over the next four years, as is implied by the interest rate decline scenario, as far lower still and well below 2.5% (approaching zero).

MPI (CAC) 8

Preamble: On page 5 of his Report Professor Simpson states:

“The only difference in the two cases is that motorists must pay higher rates initially to establish the RSR of \$200 million in the first case and have less money for personal consumption and investment decisions, which seems like a poor arrangement for both motorists and the economy.”

Is it Professor Simpson’s opinion, that it is in the ratepayers best interest to have a low RSR (or potentially no RSR), and only when an unexpected event or losses arising from non-recurring events or factors occurs, the ratepayers should then pay increases that could be significant in order to replenish the RSR or return the Corporation to a zero balance if no RSR exists? Please elaborate.

Response:

The context of the argument on page 5 is important because the intent there was not to argue for a specific RSR level but to argue the merits of a range rather than a target as a means of rate stabilization. In particular, the argument is that a target RSR of \$200 million which must be restored each year by rate increases or decreases would be as destabilizing to rates as no RSR and that a range of \$100 million to \$300 million would provide greater rate stability. I would also note that the RSR rebuilding fees of 1% per year recommended by MPI yield a rate structure (3.4%, 1%, 1%, 1%) that is less stable than my suggested structure with no RSR rebuilding fees (1.6%, 1.6%, 1.6%, 1.6%) although my suggested structure likely involves a somewhat lower RSR during part of the next four years.

MPI (CAC) 9

Does Professor Simpson agree that MPI and the PUB should be striving towards the goals of rate predictability and stability which can be accomplished partially through a range for the RSR?

Response:

Yes, but we should recognize that the rate stability provided by the establishment of an RSR comes at a cost to motorists in terms of higher rates than would be necessary in the absence of an RSR. Hence, the benefits of the RSR have to be balanced against the costs like other economic questions.