MANITOBA	Order No. 150/05
THE PUBLIC UTILITIES BOARD ACT	
THE MANITOBA PUBLIC INSURANCE ACT	
THE CROWN CORPORATIONS PUBLIC REVIEW AND ACCOUNTABILITY ACT	November 14, 2005

Before: Graham F. J. Lane, C.A., Chairman
Leonard Evans, Member
Eric Jorgensen, Member

AN APPLICATION BY MANITOBA PUBLIC INSURANCE FOR AN ORDER APPROVING COMPULSORY DRIVER AND VEHICLE INSURANCE PREMIUMS FOR THE YEAR ENDING FEBRUARY 28, 2007, AND OTHER MATTERS.

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Appendices

1.0 EXECUTIVE SUMMARY

By this Order, the Public Utilities Board (the Board), among other things, directs Manitoba Public Insurance Corporation (MPI) to:

a) provide a premium rebate to policyholders on record as of December 31, 2005 in 2006/07 of 10% of the motor vehicle premiums paid for basic compulsory insurance for the 2004/05 insurance year, the estimated $58 million rebate is to be paid separate from the premium collection process; and

b) increase motorcycle rates by an average of 5% rather than the proposed 12.7%; the reduction should not affect the premiums for any other class. The reduction acknowledges the potential rate implications arising out of the previous Board-directed change to MPI's claims allocation methodology slated to take effect for 2007/08.

This Order follows an October 2005 public hearing held to review MPI's application for 2006/07 compulsory Basic Insurance (Basic) base rates and premiums. MPI's application projected Rate Stabilization Reserve (RSR) balances rising through 2009/10 to levels well beyond the Board's allowable maximum RSR range (maximum as amended in this Order, $100 million). Basic Net Income was $59.1 million in 2004/05, and the updated forecast for 2005/06 projects Basic Net Income of $52.1 million.

The RSR was $135.8 million as of February 28, 2005. In the first day of the following fiscal year, this being the current fiscal year, 2005/06, MPI transferred in approximately $20 million from the retained earnings of the Extension and Special Risk Extension (SRE) lines of business. MPI also segregated $40 million from the RSR to form the Immobilizer Incentive Fund (IIF).

With the estimated $58 million rebate offset by forecast 2005/06 Basic Net Income and transfers from Extension and SRE, the Board anticipates the RSR, including the IIF, will approximate $145 million as of February 28, 2007. This would leave the RSR still well above the upper limit set by the Board and raise the potential for a further future premium rebate.

The Board accepts MPI's proposals with respect to premiums, fees and discounts for 2006/07, as amended by the Board's direction with respect to motorcycles.

Accordingly, average premiums in 2006/07 for major vehicle classes will change as follows:

a) private passenger vehicles - an average 0.5% decrease ;
b) commercial vehicles – an average 9.2% increase;
c) public service vehicles – an average 0.7% increase;
d) trailers – an average 4.9% decrease;
e) off-road vehicles – an average 20% decrease; and
f) motorcycles – an average 5.0% increase.

With the exception of the reduction to MPI's proposed average motorcycle premium increase, no change in overall premiums will occur for 2006/07. The rebate is on account of excess RSR arising out of events that have already occurred. MPI's current projections do not warrant an immediate reduction in future premium levels, though the projections suggest that RSR will remain above the Board's herein revised maximum notwithstanding the premium rebate.

The Board endorses MPI's anti-theft initiative. As well, the Board looks forward to substantial future improvements in customer service and road safety arising out of MPI's assumption of responsibility for driver licensing and vehicle registration functions formerly carried out by the Province.

At the hearing, the Board found the following matters of particular interest:

(a) the level of the Basic Insurance Rate Stabilization Reserve (RSR) and the test to be applied to determine its adequacy: the Board rejects MPI's proposed application of the minimum capital test (MCT) used to regulate private insurers, concludes the RSR is in excess of requirements, and directs a 10% premium rebate;

(b) the assumption and integration of Driver Vehicle Licensing (DVL) functions and related matters: while the transfer provides a long-awaited opportunity to improve service and enhance road safety, it is expected to materially reduce Extension and Basic Net Income potential over the next five years;

c) MPI's anti-theft initiative;

d) the implications for rates of the Board's previous "Loss Transfer" decision (the Board notes MPI's observation that actuarially-indicated premiums for the motorcycle class will likely decline and commercial premiums increase under the new claims allocation method);

e) MPI's plans to review the operations of the Personal Injury Protection Plan (PIPP), the Bonus/ Malus system and DVL functions (the Board supports a thorough review of these operational segments);

f) MPI's investment asset mix (the Board expresses continuing concern with the yield and future investment income implications of the current asset mix);

g) moped classification (the Board encourages a separation of private-use owned mopeds from mopeds held in rental fleets);

h) inter-provincial trucking (subsidization of trucking firms at the cost of other vehicle owners is present);

i) road safety (the Board expresses concern over reduced police traffic infraction enforcement, and suggests amendments to the Bonus/ Malus system);

j) single-vehicle accidents (the Board directs MPI to research the causal factors of single-vehicle accidents and the link of cause and claims attribution in the rate-setting methodology);

k) claims handling and other operating costs (being mindful of the DVL integration, the Board notes the cost experience of other public auto insurers and highlights a need to constrain costs); and

(l) environmental matters (the Board concludes that the interplay between insurance and environmental principles is yet to be fully understood, and recommends further research).

The Board finds MPI well managed and its Basic Insurance program of benefit to policyholders. The Board expresses its appreciation of MPI's co-operation throughout the regulatory process, an integral component of the efficacy of regulatory review.

2.0 INTRODUCTION

MPI applied to the Board in June 2005 for approval of 2006/07 premiums for compulsory vehicle and driver insurance under its Basic Automobile Insurance Plan (Basic). The process followed was, and this Order is, pursuant to *The Crown Corporations Public Review and Accountability Act, The Public Utilities Board Act, and The Manitoba Public Insurance Corporation Act*.

MPI's operations are divided into two main segments:

a) Basic, that is regulated compulsory insurance ; and
b) unregulated and competitive lines of business (Extension and SRE).

MPI has a monopoly with respect to Basic and has in excess of 80% of the market for the competitive lines. In addition, MPI has recently established a new "line of business" within Extension, that being its recently acquired DVL functions.

Extension and SRE lines of business are related to MPI's Basic line in three major ways:

a) all are delivered by one overall organization, MPI;
b) common costs are allocated by formula between Basic, Extension and SRE (the Board suggests that the allocation formula requires amendment to take into account DVL) ; and
c) deemed excess retained earnings of both Extension and SRE support Basic RSR.

Established by provincial legislation in 1971, MPI's goals include:

1. Providing universally available mandatory motor vehicle insurance;

2. Providing lower premiums than private insurers for comparable coverage and service;
3. Returning 85% of premium revenue in claims benefits;
4. Being a leader in automobile insurance through providing superior products, coverage and service;
5. Providing responsive, fair, courteous and convenient customer service;
6. Maintaining a Rate Stabilization Reserve;
7. Managing an internal environment attractive to productive improvement-minded people;
8. Treating employees with respect and fairness;
9. Leading initiatives on driver education and training; and
10. Increasing public concern over risky driving behaviour.

Although MPI did not request an increase in premium revenue from rates, the vehicle upgrade and volume factors (replacement of older units with newer ones and the annual increase in the number of insured units) provide annual revenue increases even in the absence of premium rate adjustments. From the upgrade and volume factors, MPI consistently has projected annual premium revenue growth in the range of 5%.

Premiums for all major vehicle classes continue to include annual experience adjustments capped between -15% and +15%, in most cases. Overall, rate increases and decreases are capped at 20% as a result of Board Order 148/04. As was the case in previous years, classification offsets are applied to achieve revenue neutrality.

MPI requested increases in neither Driver License Premiums nor fees. MPI proposed a continuation of the $40 discount for customers having Vehicle Information Centre of Canada (“VICC”) approved after-market or dealer installed anti-theft devices.

MPI supported its anti-theft initiative, including the segregation of $40 million of Retained Earnings to meet the projected cost of the initiative. MPI forecast that the immobilizer initiative will eventually yield claims savings of twice the cost of the project. Funded by the IIF, MPI offers incentives to bring voluntary increases in the number of vehicles with immobilizers. This should advance the transition to theft-proof vehicles that is expected to eventually arise from Transport Canada's directive that all new vehicles be equipped with immobilizers starting with the 2008 model year. The average age of insured vehicles in Manitoba is nine years.

The Board held a pre-hearing conference on July 5, 2005 that considered the procedures to be followed at the public hearing and dealt with the registration of interveners. Subsequently, the Board provided intervener status to the groups specified in the following paragraph, established a timetable for the orderly exchange of information ahead of the October public hearing, and set out procedures to be followed.

Interveners were the Canadian Automobile Association – Manitoba Division (CAA), Coalition of Manitoba Motorcycle Groups (CMMG), Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors (CAC/MSOS), Insurance Brokers Association of Manitoba (IBAM), Manitoba Bar Association (MBA), Manitoba Used Car Dealers Association (MUCDA); and Scootering Manitoba. Interveners assist the Board in the protection of the public interest by involvement at all stages of the process.

In addition to the interveners, there were a number of presentations made to the Board by individuals as well as by an environmental group. MPI agreed during the hearing to provide a response to each of the presenters with respect to their specific concerns.

This Order sets out the Board's findings, recommendations and directions on matters of interest as referenced through testimony at the hearing or filed documentary evidence. In order to improve readability, this Order is structured differently than has been the case for previous Orders. Rather than reproducing the stated views of interveners on each topic, transcripts of the hearing are now posted on the Board's website, www.pub.gov.mb.ca/mpitrans.html. Posting allows public access to the full record of the hearing, including cross-examination of MPI witnesses by the Board and by interveners.

Exhibits placed on the record at the hearing may be viewed at the Board's offices on request. The Board suggests interested parties peruse MPI's Annual Report and quarterly financial statements, which may be found on MPI's website (http://www.mpic.ca).

3.0 BOARD FINDINGS

The Board appreciates the contributions made and cooperation extended by MPI and the Interveners during the General Rate Application (GRA) process. The Board also expresses appreciation to the Presenters who took the time to appear and make their views known. As the Board's jurisdiction and process is limited, Presenters bring perspectives on issues of interest not necessarily addressed by the other participants.

MPI is important to Manitoba, not only for its insurance offerings and service but also with respect to its investments. MPI's investment pool is one of the largest in Manitoba, and a significant portion of that pool provides capital at reasonable interest rates to Manitoba's public sector. Further, MPI's insurance rates and benefits are arguably among the best in the country.

The Board's findings reflect the evidence provided through the GRA process, and provide the Board's determination of the public interest. The Board interprets the "public interest" to include not only issues of particular concern to policyholders but also the broader interests of society, inclusive of the objectives initially established for compulsory motor vehicle insurance and the financial health and stability of MPI.

The Board finds:

a) MPI's application for Basic premiums and fees for 2006/07 acceptable, subject to a Board direction that motorcycle premiums be increased by an average of 5%, rather than the 12.7% requested;
b) the RSR is in excess of current and projected requirements, and will therefore direct a 10% premium rebate;
c) a Risk Analysis, supported by a Value at Risk Analysis, represents an approach tailored for MPI's situation and circumstances that the Board continues to find efficacious;
d) the RSR range requires amendment, and the Board resets the range to $65 million to $100 million;
e) the IIF is a component of RSR for purposes of assessing RSR adequacy;
f) opportunity yet concern with the projected effects on Basic from the transfer of DVL from the Province, its placement within the unregulated Extension Division of MPI, and the continued loss of annual commission offset payments from the Province;
g) MPI's anti-theft initiative, including both the immobilizer program and the Winnipeg theft suppression pilot project, is reflective of the public interest;
h) MPI's plan to proceed with an independent review and the establishment of benchmarks of and for PIPP is important and is supported and strongly encouraged by the Board as a means of better assuring on-going cost-effectiveness and good customer service;

i) MPI's intent to review and upgrade the Bonus/ Malus system and all DVL and related Basic administrative functions, in concert with a review of Basic functions, should be followed through as expeditiously as possible, with the objectives of improving customer service, reducing the current "worst case" projection of deficits on DVL operations, and, reducing the incidence and severity of injuries by bringing about improvements to the Bonus/ Malus system;

j) the more appropriate way to analyse MPI's investment performance is on a market value basis, the exception being with respect to its Manitoba-based bonds, those having been acquired as part of its *invest in Manitoba* mandate and expected to be held until maturity;

k) MPI's investment portfolio and related revenues to be significant enough to warrant consideration of further diversification to optimize returns while balancing liquidity against the timing of liabilities;

l) the payment of investment management fees to the Province for the portion of the portfolio invested in Province of Manitoba securities would best not continue, a change related more to the avoidance of a perceived conflict of interest rather than to cost-effectiveness;

m) the current approach to inter-provincial truck premiums subsidizes trucking firms at the cost of other vehicle owners, and therefore the Board suggests that MPI consider options to reduce or eliminate the subsidy;

n) benchmarks need to be developed to allow MPI to effectively assess road safety actions and plans, particularly with new opportunities now available through its assumption of DVL functions;

o) benchmarks need to be identified and analyses undertaken to provide assurance that claims handling and other operating expenses represent cost effective administration; and

p) given concerns with reduced traffic infraction enforcement in Manitoba, MPI should consult with the RCMP, the Winnipeg Police Service and the Province to address it – the incidence and severity of accidents and injuries remain far too high (reforms to the Bonus/ Malus system should take into account red light camera infractions).

Background and rationale for the Board's findings follow.

Rates

With the exception of the Board's conclusion that average motorcycle rates should be limited to an increase of 5% in 2006/07, the Board will approve MPI's application for base rates and premiums for 2006/07.

MPI's ratesetting methodology is well established and is thoroughly tested at the annual rate hearings. The Board notes that the approach continues to be actuarially sound and statistically driven. That said, ensuring fair rates across all major classes and rate groups can be difficult given the reduced credibility associated with low vehicle "population" in certain categories. The design of the system, subject to review at the annual hearings and amendment, together with review by the Board's actuarial advisor, provides sufficient support to allow adequate confidence. As well, the Board-approved overall cap of 20%, which means that no vehicle premium may be increased or decreased by more than 20% in any year, provides assurance of reasonable attention to the risks of rate shock.

Adequacy of RSR

MPI has long defined its RSR as "intended to protect motorists from rate increases made necessary by unexpected events and losses arising from non-recurring events or factors".

A summary of the RSR from fiscal 2001/02 projected out to fiscal 2009/10, as presented by MPI, follows:

Basic Insurance Rate Stabilization Reserve

($ millions)

	Actual			**Forecast**					
Fiscal Years Ending February 28, 29	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
RSR, opening balance	143.0	50.5	35.4	42.8	135.8	167.3	190.7	201.1	215.7
Net income (loss)	(11.7)	(30.1)	3.4	59.1	52.1	4.5	(1.6)	4.1	6.2
Surplus dividend/IIF	(80.8)	.5	-		(40.0)				
Transfer from SRE	-	14.5	4.0	29.6	8.4	11.8	7.3	7.5	7.6
Transfer from Extension	-			4.3	11.0	7.0	4.8	2.9	0.9
Total RSR	50.5	35.4	42.8	135.8	167.3	190.7	201.1	215.7	230.4

Board Order 151/00 confirms and establishes the Board's understanding of the purpose of the RSR:

> "As a basic principle…, the RSR should be utilized to protect motorists from rate increases that would otherwise be necessary because of losses from unexpected and non-recurring events. This is consistent with the Corporation's stated view … The RSR should not be used to offset base premiums increases which would otherwise be necessary to ensure that forecasted revenue is sufficient to cover forecasted costs in a particular fiscal year…"

One of the most significant matters addressed at the hearing was the issue of RSR adequacy. It has been long established that if and when the upper target limit for the RSR is breached, there is a strong case for a rebate of premiums.

Major factors and events speaking to this issue include:

a) the RSR balance reported in the audited financial statements for MPI as at the end of its last full fiscal year;
b) the establishment of the IIF in fiscal 2005/06;
c) projections for Basic Net Income for 2005/06 and 2006/07;
d) the outlook for Basic Net Income through to the end of the 2009/10 fiscal year;
e) projected RSR for all future fiscal years through 2009/10;
f) transfers into RSR out of Extension and SRE made on March 1, 2005;
g) MPI's past forecasting record;
h) unrealized gains on investments, and forecasts of investment income;
i) reinsurance arrangements;
j) projected investment portfolio balances and asset mix;
k) projected balances for the Provision for Unpaid Claims, and the growth of the PIPP component;
l) the Provision for Adverse Deviation (PFAD);
m) the Board's range for RSR adequacy;
n) the test of RSR adequacy previously adopted by MPI's Board of Directors, Risk Analysis, and the Board of Directors previous RSR adequacy range of $80 million to $100 million;
o) the understanding in place with respect to actions to occur or be considered when the RSR range is exceeded;

p) the replacement for Risk Analysis adopted by MPI's Board of Directors, the Minimum Capital Test (MCT), and the Dynamic Capital Asset Testing (DCAT);

q) practices and policies of other insurers and regulators; and

r) the positions of Interveners, representative of the perspective of policyholders.

MPI's RSR balance at the end of fiscal 2004/05 was $135 million, which exceeded the Board's approved maximum of $80 million (understood to be subject to an inflation factor based on increases in Gross Written Premiums). The Board accepts the projection of an inflation-adjusted Board range of $55 million to $90 million as of February 28, 2005, as calculated by Mr. John Todd, who testified at the hearing on behalf of CAC/ MSOS. To account for anticipated further growth in Gross Written Premiums through 2009/10, the Board further amends its approved RSR range to $65 million to $100 million.

The approximately $20 million transferred from Extension and SRE retained earnings into the RSR on March 1, 2005, the first day of the current fiscal year, is considered to be part of the Basic RSR for the purpose of determining RSR adequacy at February 28, 2005. The transfer arose out of net income earned in prior periods deemed by MPI's Board of Directors to be in excess of required retained earnings.

With respect to the IIF, the Board accepts MPI's reformulation of Basic Retained Earnings to provide for the segregation of $40 million within the RSR. The Board has no difficulty in MPI's providing transparency with respect to its cost obligations and business risks associated with the anti-theft initiative. That being said, and given the Board's comfort with the initiative and MPI's projection of long-term benefits arising out of the initiative, the Board, as previously indicated, considers the IIF a component of RSR for purposes of assessing RSR adequacy.

As cited by Mr. Todd, the Board has consistently reached its conclusions on the adequacy of the Basic RSR based on the specific risks faced by MPI. Recently, MPI and the Board have relied upon two analyses to support a range for the RSR:

a) Basic Autopac Operational and Investment Risk Analysis (Risk Analysis); supported by a

b) Value at Risk Analysis (VaR).

Together these analyses represent an approach tailored for MPI's situation and circumstances that the Board continues to find efficacious. According to the Risk Analysis filed in 2001, the methodology "assesses the underlying volatility … (of risk), and then combines them using standard portfolio principles which considers the correlations amongst the variables, in essence including the diversification effect."

In Board Orders 154/98, 177/99 and 151/00, the Board disagreed with various aspects of the Risk Analysis presented by MPI, and sought refinements. In Order 151/00, the Board stated its desire to finalize the issue of what was to be the appropriate RSR target, and MPI submitted an updated Risk Analysis. In Order 179/01, the Board, based on the results of the then-latest risk analysis, established a RSR range of $50 to $80 million. MPI reaffirmed its RSR target range of $80 million to $100 million, to be in force for a period to end February 28, 2006.

At last year's rate hearing, MPI reported no material changes in its risk profile warranting an update to the Risk Analysis it had presented in the fiscal 2003 Application. MPI also indicated no immediate plans to further update the Risk Analysis. MPI advised that in future it would prepare a DCAT to assess risk. The DCAT is generally used within the insurance industry to review future financial condition; it projects operating results considering the insurer's business plan, and then subjects those projections to a variety of plausible adverse stresses, in part to provide information on the course of events that could lead to capital depletion, and to identify the relative effectiveness of alternate corrective actions.

The Office of the Superintendent of Financial Institutions (OSFI) requires private sector insurers to report on financial condition, and has accepted the DCAT approach to be a recognized method of assessing the *risk of insolvency* in the private insurance industry, where solvency is a concern. MPI indicated that the DCAT was prepared as information to assist in understanding its level of risk with respect to RSR requirements. The 2003 DCAT indicated however that, since MPI is a monopoly, rate changes to address adverse developments were less problematic than in the private sector. The DCAT acknowledged that the Board RSR range minimum of $50 million at that time was less than private industry requirements.

The Board concluded in 2000 that the RSR's minimum and maximum "trigger points" were appropriate at $50 million and $80 million. A RSR below $50 million would give rise to serious consideration of higher rates; a RSR above $80 million would lead to consideration of premium rebates.

Subsequently, Order 148/04 provided an indication that the RSR range's minimum and maximum should inflate in accordance with increases in annual Gross Written Premium; a CAC/MSOS witness suggested at this year's hearing that this factor should increase the current range to between $55 million and $90 million. Notwithstanding the Board's view, MPI maintained that it required a higher range of $80 million to $100 million, from 1999 to this year's rate hearing.

With respect to methodology, the Board noted in Order 177/99:

> " … it is important to include consideration of budget forecasting accuracy in the Risk Analysis since the RSR is to be used only for the unforeseen (i.e. not budgeted) non-recurring events. If the events are foreseeable … the Corporation should include them in the revenue requirement for the upcoming year; and … not expect to draw down the RSR. … the Risk Analysis should determine how the variances in the relevant costs and revenue items may impact on net income and cause a contribution to, or to draw upon, the RSR…. the risk to be considered is to be the risk that actual costs and revenues will differ from the forecast built into rates because forecast revenues and costs are used for ratesetting purposes. Rates should address expectations of the foreseeable costs, and therefore should fail to cover … costs … only when forecasts prove to be inaccurate."

In conclusion, the Board stated that it "... expects that in the future, MPI will still use the methodology and statistical approach contained in the present Risk Analysis, but will … chang(e) the variable inputs."

Until MPI decided to abandon the Risk Analysis approach, the differences between its RSR range and that selected by the Board were relatively modest (only $20 million for the range maximum).

However, at the October 2005 hearing, MPI adopted the MCT methodology prescribed by OSFI, the federal regulator of private property and casualty companies. In advising of its decision, MPI cited four factors requiring a higher RSR range than previously accepted by the Board and itself, these being:

a) higher retentions in its reinsurance arrangements;

b) a Provision for Unpaid Claims that was growing “exponentially”;

c) a large and rapidly growing investment portfolio; and

d) an upcoming requirement for “mark-to-market” investment valuations.

MPI abandoned the fourth reason during the hearing as being irrelevant, but held to the first three. The Board notes that MPI has regularly amended its reinsurance retentions and coverage and that previous amendments have not led to requests for adjustments to the RSR range. This does not mean that reinsurance charges are not significant.

As to the size and growth of the Provision for Unpaid Claims and the investment portfolio: the Board notes that:

a) the former is expected to grow until the PIPP program was fully matured (outstanding claims rising only in accordance with volume increases of policyholders); and

b) the risk associated with the latter has not changed materially since last year.

MPI confirmed the Board’s perspective on the nature of the risks during the hearing, when it confirmed that no new risks had been identified, and that its concern was related to the quantum involved. The Board notes the Risk Analysis provides a means by which MPI’s assertions can be tested.

MPI’s external actuary indicated that, pursuant to the MCT, MPI’s proposed range for the Basic RSR was acceptable at $107 million to $214 million, the former level being 50% of the value determined under MCT. MPI selected 50% of MCT as the minimum level for RSR in recognition of its status as a Crown Corporation with a monopoly. The effect of the adoption of these MCT based targets was MPI’s assertion that current and projected RSR levels were not and would not be in excess of RSR requirements, i.e. no return to policyholders should occur.

As indicated previously, the MCT range is based on the results of the DCAT process. The DCAT process tests identified adverse event scenarios individually, and only explores the integration of two or more adverse scenarios if one or more of them are considered to be of comparable probability to the base scenario. Typically, the objective is to test adverse scenarios that reflect a consistent plausibility level of about a one in one hundred year event occurrence, and so integration of two or more adverse scenarios is usually not an issue. Of course, it is all but impossible to be precise in defining adverse scenarios.

The MCT for any given year end, as it is intended to be calculated annually, is a ratio calculated using OSFI-prescribed factors applied to historical or projected financial statement values. MCT results are typically compared between the base scenario and the various adverse scenarios as part of the process of determining which adverse scenarios are the most severe.

The MCT results proposed by MPI for use for the 2006/07 fiscal year were for the base scenario. Those MCT results were referenced because MPI lacks the technical ability to compute MCT ratios on its own. MPI advised the Board that in due course MCT ratios would become an integral part of schedules provided in support of its annual rate application.

With respect to the a comparison between the base scenario of the DCAT and MPI’s business plan forecast, unless MPI’s planning process is fully integrated with the DCAT process there will be differences between the two forecasts: two processes, developed by separate bodies, are involved. Many assumptions underlie the DCAT base and adverse scenarios, and considerable judgement is required.

Except for the conclusion of MPI's external actuary that MPI's financial condition, and hence its RSR, was not satisfactory, the Board's perspective of the DCAT presented to this year's hearing was that it provided historical projected base scenario MCT ratios. The similarity between the DCAT base scenario and MPI's business plan forecast as presented to this year's rate hearing, in broad terms, is evident from a comparison of projected retained earnings levels and details in the projected income statement.

The Board proceeded in its evaluation of MPI's proposed employment of the MCT test to establish its RSR range by separating its consideration into two steps:

a) assess the merits of the MCT as a measure of the adequacy of RSR; and,
b) if the Board determined the MCT to be more meritorious than the current Risk Analysis test process, then to proceed to assess what level or range of MCT would be appropriate as an operating range for MPI's RSR. The Board notes that a MCT of about 50%, or $107 million, as estimated for the end of 2005/06, is fairly close to the upper limit of the Board's range for an acceptable RSR and to MPI's previously adopted upper range.

MPI advised that OSFI requires regulated property and casualty companies to have deemed capital (deemed since balance sheet capital is risk-adjusted for MCT purposes) sufficient for a 150% MCT ratio. MPI also reported that, as at the last reporting date, the industry had capital sufficient for an MCT ratio in excess of 200%.

Private property and casualty insurers are subject to risks not extant with a monopoly Crown Corporation. As well, policyholder and hence regulator concerns with respect to insurer solvency are of a different magnitude and kind compared to the situation with a Crown Corporation. Simply put, the Board does not accept that a policyholder of MPI has any risk that a proper claim on MPI will not be honoured.

While MPI's RSR, the equivalent of the capital of a private insurer, is required as a hedge against the risk of rate shock arising out of an unexpected and non-recurring event, the private insurer's capital has to be sufficient to ensure continued solvency to meet claims. MPI can reasonably expect favourable consideration of future proposals for rate increases if necessary to meet appropriately forecast costs. A private insurer cannot be assured that a rate increase will not result in diminished business and increased insolvency risk.

A Crown Corporation with a province as its sole shareholder has an ability to influence legislation and regulation not available to a private insurer in a competitive market. Adjustments may arise out of the upcoming Bonus/ Malus review that could substantially alter the incentives and penalties provided to and assessed against motorists for their driving approach and experience. As well, MPI's anti-theft initiative could prove more successful than current forecast. With current annual costs ascribed to "theft" running to $40 million, substantial claims incurred improvements may occur over time as thefts decline.

In short, the Board does not accept the MCT as being a necessarily better determinant of an acceptable RSR range for MPI than the Board's current approach; nor does it accept an arbitrary selection of 50% of MCT as the minimum for a RSR range for MPI.

However, the Board has amended its current RSR range and now believes that a $65 million to $100 million range is appropriate to reflect future increases in Gross Written Premiums for 2009/10. MPI may update the Risk Analysis if it wishes to challenge this range at a subsequent rate hearing. Barring more evidence on the subject, the Board expects to maintain this range through 2009/10. If MPI wants the Board to reconsider the acceptance of the MCT as the determinant of the RSR range in the future, the Board will require a direct comparison between the MCT and an updated Risk Analysis. The Board is reluctant to adopt a private sector test as the determinant of MPI's RSR range when other means more appropriate to MPI's unique circumstances are available.

The forecasts and financial outlooks provided by MPI do not give rise to concern with respect to "foreseen" events. MPI projects no need for annual revenue increases beyond the normal upgrade and volume factors that provide additional revenue without the need for an overall average premium increase through to and including 2009/10.

The Board observes that the PFAD has doubled in magnitude over the past five years, and amounted to approximately $189 million as of February 28, 2005. And, with respect to the discount rate used in the calculation of Unpaid Claims, the Board observes that while it is within the range of accepted actuarial practices, it is not at the higher acceptable level that would develop a reduced Provision for Unpaid Claims and higher RSR. In saying this, the Board is not inferring that the PFAD is excessive, but indicating that MPI has the protection a fully acceptable PFAD.

Similarly, the Board notes the recent pattern of overall Net Income variances from forecasts, and finds the Corporation to be, understandably, conservative in its estimating. The Provision for pre-PIPP bodily injury liability claims has, in recent years, been consistently found to be in excess of requirements and adjusted at year-end. In 2004/05, the Provision for Unpaid Claims was reduced by over $50 million following an actuarial review, as the previous estimates of liabilities arising out of prior years were found to be in excess of requirements.

The Board notes MPI's policy decision to transfer deemed excess retained earnings of SRE and Extension to the Basic RSR, and observes that this source of Basic RSR funding has been an important component in the growth of the RSR. The Board notes that MPI has indicated no change to this policy. MPI reported that the approved maximums for the retained earnings of Extension and SRE established by MPI's Board of Directors had been revised to:

Line of Business	**Target Level**
SRE	$37 million
Extension	$35 million

MPI has advised that due to competition and other factors, Extension and SRE annual earnings may vary widely, and accordingly, the maximum retained earnings target levels for SRE and Extension are reviewed annually. With the forecast losses associated with DVL operations, Extension Net Income forecasts cannot be ascribed the confidence previously provided.

At the 2004 GRA hearing, MPI projected aggregate net income for Basic for 2004/05, 2005/06 and 2006/07 at an accumulated loss of $9.4 million. The current forecast for the same period is for net income of $115.7 million, an improvement of $125.1 million (over twice the premium rebate directed by this Order). The two main contributors to the positive variance were an actuarially supported reduction in the Provision for Unpaid Claims with respect to pre-PIPP bodily injury claims and realized gains on the sale of securities.

The Board concludes that the RSR is in excess of current and projected requirements and directs a 10% premium rebate (approximately $58 million). The Board notes previous deliberations and confirms that refunds are appropriately paid to those who contributed to the surplus. Therefore, the rebate is to be provided to Basic policyholders of record in 2004/05, as long as they remain policyholders as of December 31, 2005, and is to be paid in 2006/07. The payment is to be made independently of premium collection so that it is clear to policyholders that rebates are "one-time" events and do not necessarily indicate that average premiums should be reduced.

Finally with respect to the RSR issue and the Board's decision to direct a "return" of excess RSR to Basic policyholders, the Board has considered the perspective of Interveners to the hearing. CAA, CMMG and CAC/MSOS all called for a premium rebate, after having heard and considered MPI's rationale for higher RSR levels and no rebate. While none of the Interveners have expressed any view other than a desire for a financially-strong public insurer, they all called for a rebate given the present circumstances.

DVL Transactions

The Board reiterates concern expressed in Order 148/04 as to the effects on Basic from the transfer of DVL from the Province, its placement within the unregulated Extension Division of MPI, and the loss of annual commission offset payments from the Province. In aggregate, the Board notes that in MPI's worst case scenario, Basic can expect to receive $70 million less over five years in commission offset payments and transfers from Extension than may have been the case in the absence of the transfer of DVL functions, subsequent expenditures planned to overhaul DVL and related Basic functions, and the loss of the commission offset..

Preceding the transfer of DVL, and as indicated by MPI, the Province unilaterally cancelled a longstanding annual commission offset payment by the Province effective the last quarter of

2003/04. As well, at last year's rate hearing, MPI advised the Board that the DVL transfer was made on the basis that it would not negatively affect insurance rates. That assumption appears on the surface to be contradicted with the reality of today. Only a successful integration of DVL into Basic operations that eliminates deficits on DVL operations and an enhanced Bonus/ Malus system that leads to reduce accident frequency will make these changes cost effective in the longer term for Basic policyholders.

The loss of the commission offset directly reduces Basic's RSR, with implications for rates, just as the deficits now forecast for DVL operations within MPI will decrease Extension net income and subsequent potential transfers from Extension retained earnings into Basic RSR.

MPI has stated: "… the termination of th(e) shared cost agreement (loss of the commission offset) was a separate and distinct issue totally apart from the merger of DVL and MPI." Though the Board accepts MPI's assertion, the result of the combination of the two events is a projected RSR balance in 2009/10 that is $70 million less than it would otherwise be.

DVL was a provincial government operation until its transfer to MPI in 2004. DVL administers the registration of motor vehicles, assesses fees for vehicle registrations, regulates driver licenses, and administers the Driver Class Licensing Program. Through this program, drivers are required to meet the specific vision, physical ability, road safety knowledge and skill standards for each particular class of vehicle. DVL also administers the merit-demerit point system and accident surcharge impositions, both integral to MPI's Bonus/ Malus system.

MPI noted that the objectives for the transfer include customer service improvements, cost savings, increased efficiency and the reduction of Basic/ DVL overlap and duplication. If there are cost savings to be achieved, at least for the next five years they will accrue to the government since MPI is forecasting $20 million of new expenditures for a Business Process Review and five-year DVL operating deficits totalling $40 million. For MPI and its policyholders, the financial advantages of the DVL transfer may come in time, but not at least for the next five years based on current forecasts.

The Board has no difficulty with MPI's plans to bring about the creation of a new model for meeting the licensing, registration and insurance needs of Manitobans. It has long supported the amalgamation of DVL and MPI. Its concerns rest with the cost of the venture and the sharing of those costs during the transition period when cost savings opportunities and synergies are in the development phase.

The evidence presented at the hearing by MPI did not project long-term cost benefits; it did however quantify the anticipated DVL cost deficit for a five-year period. The Board observes that from the evidence presented at the hearing it is unaware if the Province has knowledge of the projected deficits with respect to MPI's operating of DVL and the effect of those losses on Extension and Basic RSR.

Also unhelpful to consideration by the Board of DVL related issues was MPI's placement of DVL into Extension rather than Basic. Extension and SRE lines of business are not regulated by the Board, and the avoidance of the purview of the Board was suggested by MPI in last year's hearing as being the motivation for the placement in Extension rather than Basic Insurance. This is not a valid reason for locating a critical component to long-term road safety within a division not subject to the Board's review.

DVL's connection to MPI's unregulated and competitive lines of business, SRE and Extension, is tangential in nature compared to the "cause and effect" relationship and importance to mandatory Basic Insurance operations. Leaving aside the revenue derived from driver license fees, the regulation of drivers and the road-worthiness of their vehicles are of critical importance to MPI and the future level of insurance premiums. As well and as previously indicated, DVL manages the Bonus/ Malus system: an effective Bonus/ Malus system is an important predictor of Basic costs and rates.

Since the advent of the Bonus/ Malus system in 1988, MPI has claimed an inability to refine the Bonus/ Malus system due to the Province's ownership and control of DVL. MPI regularly contended that the limitations of DVL's computer systems determined the Bonus/ Malus options, and that the system was constrained by initial design and age and outside MPI's authority to change.

At last year's hearing, the Board heard evidence that the incidence of vehicle accident injuries in Manitoba is among the highest in Canada. (At this year's hearing, MPI suggested that Basic's generous benefits affect claims volumes in Manitoba.) Nonetheless, through actions taken by DVL, accident and injury incidence can be positively affected. The Board and the Interveners have a continuing and strong interest in participating in discussions related to DVL's functions, responsibilities and actions.

The Board's interest in DVL functions goes beyond the enthusiasm for changes to the Bonus/ Malus system. There is the matter of the projected five-year deficits of $40 million.

Approximately three hundred employees of DVL became MPI staff members with the transfer. Along with the compensation, occupancy and other costs associated with a workforce of that size, the DVL computer system requires a major upgrade. As previously indicated, MPI plans to spend $20 million on a Business Process Review of DVL. Yet, under the terms of its agreement with the Province, MPI will receive a flat annual payment of $20.9 million towards the cost of DVL functions, an amount suggested by MPI to be representative of DVL's 2003 budget, without an inflation factor.

The provincial payment will not vary regardless of expense level changes unless additional functionality is added to functions associated with the Province's revenue stream from DVL operations. As well, the income derived from DVL operations with respect to vehicle registrations and driver license fees will continue to flow to the Province, without a commission offset to MPI's commission payments to brokers. And, collective agreements will be re-negotiated, likely with higher compensation costs, and these cost increases will also fall to MPI.

MPI suggests that savings could be expected to arise from operating synergies to be identified through the review, and opined that as synergies are developed, MPI would achieve overall administrative savings to the benefit of MPI and its policyholders, as well as improvements in customer service. However, MPI was not prepared to disclose to the Board the terms of reference for its upcoming review of DVL, and it indicated that any changes to DVL affecting the Province will require the Province's agreement.

The Board surmises that the review of DVL functions may well develop opportunities not only to improve Bonus/ Malus but to bring down overall operating costs through synergies achieved through the fuller integration of DVL functions with MPI and its Basic operations. The Board understands that a portion of the deficits now forecast for DVL operations relate to planned reorganization and technology upgrades. Sufficient savings to eliminate the deficits now anticipated might develop over time. However, in the mid-term, any savings that may arise might only mitigate the additional costs MPI now forecasts to incur because of the transfer and the potential operating improvements.

Outside the purview of the Board, deficits associated with MPI's DVL operations will shrink the transfer of Retained Earnings of Extension to Basic's RSR. And, with DVL outside the purview of the Board, the Board lacks the ability to reach a firm conclusion on the reasonableness of MPI's assertion that the transfer will prove cost-effective over time.

Accordingly, the Board can have little assurance as to the reliability of MPI's forecasts of future annual transfers from Extension to Basic Insurance and its RSR. As matters now stand, the costs of operating the DVL division, including potential and long overdue computer upgrades, is expected to reduce the transfer of funds from Extension to Basic Insurance and the RSR by $40 million over the next five years. Absent this flow of income into the RSR, future rates will likely be higher than they would otherwise be.

There is another problem with the transfer and the location of DVL functions within Extension outside of the Board's purview. Over time, the costs associated with the DVL functions may become difficult to identify as DVL and Basic functions are integrated. Unless the revenues and costs associated with the functions of the current DVL operation are segregated, it will not be possible to know the long-term effect on Basic.

The Board reiterates its recommendation of last year that MPI reconsider the placement of DVL, and instead place it in Basic within the purview of the Board. The Board has legitimate regulatory interest in DVL concerns, and these extend not only to the financial effects on Basic, but also include the future operations and amendments to the Bonus/ Malus system. If DVL were relocated within Basic, the Board would not consider its jurisdiction to extend to the setting of registration fees, which would remain the prerogative of the Province.

Returning to the matter of the former cost sharing related to broker commissions with respect to the brokers' responsibilities for the registration of vehicles, once again, as was the case at the 2004 GRA, MPI provided no explanation for the cancellation. The end of the commission offset payments occurred without discussion with the Board, though it clearly affects MPI Basic revenue requirements and rates. MPI confirmed at last year's hearing that the requirements of brokers related to DVL functions will continue now and into the future, and the commissions paid by MPI with respect to these functions will also continue to be paid.

The Board is particularly concerned with operational changes that may be, or are perceived to be, unfair to policyholders. Over the next five years, the combination of the loss of the commission offset ($30 million) and the projected deficits on DVL operations ($40 million based on worst case scenario) will deprive Basic RSR of approximately $70 million. The lost average $14 million per year is the equivalent of a 2% Basic rate decrease.

In Order 148/04, the Board directed MPI to reduce the revenue requirement for fiscal 2005/06 by $5.7 million, and to reduce its proposed rates accordingly to account for the loss of the commission offset. With the knowledge of the continuation of the annual loss of the commission offset and a further projected deficit on DVL operations, the Board faces another dilemma.

Last year, the Board directed MPI to reduce Basic premiums by 1% to offset the effect of the loss of the commission transfer. This year, the Board will not direct MPI to further reduce Basic rates to offset the effect of these losses related to DVL functions, but will leave it to MPI and the

Province to consider whether they have met their responsibilities to hold ratepayers failsafe in transactions with each other.

The Board will require MPI to continue to report on DVL matters, which have a connection to Basic rates through RSR development, and encourages it to be fully transparent in such reports.

Anti-Theft Initiative

The Board concludes that MPI's auto theft initiative, including not only the immobilizer program and a theft suppression pilot project involving the Winnipeg Police Service and the Province, is in the public interest.

Until 2005, MPI had reported steady annual increases in thefts and the associated costs and bodily injuries involved, particularly in Winnipeg. MPI advised that the number of thefts continued to grow ("every day of the year approximately 30 vehicles are driven up and down our streets by thieves – most of whom are young, immature and lacking basic driving skills": MPI pre-filed testimony). Despite the efforts of the police, the government and MPI, the Board was advised that the annual costs to the Corporation and its policyholders associated with vehicle theft had exceeded $35 million prior to MPI's decision to take the lead in bringing the situation under control.

MPI properly observed that a successful solution to the theft problem would require the efforts of other stakeholders as well as MPI. As well, MPI correctly noted that the costs of auto theft go well beyond finances and injuries:

> "Hundreds of young at-risk youth are jeopardizing their futures by coming into conflict with the law, incurring criminal records, establishing a law-breaking persona and building up crippling levels of financial debt. The direct and indirect costs to the justice system, the social services system and education system exceed many millions of dollars."

MPI determined that an effective and permanent solution to the problem rests in part with electronic immobilizers. While increasing numbers of new and more expensive vehicles come factory-equipped with immobilizers, and Transport Canada has directed that from the 2008 model year all vehicles must have them, the majority of the current insured fleet of passenger vehicles in Manitoba is not equipped with them. Recognizing the value of immobilizers, MPI has offered a $40 annual premium reduction for vehicles with immobilizers (the discount is "built-in" for vehicles with factory installed immobilizers), but the take-up was low and insufficient to bring about a reduction in thefts.

Therefore, MPI determined to take the lead in bringing down auto theft, and adopted a goal to resolve the problem of auto theft by 2011. As a key component in its plan, MPI introduced an immobilizer incentive program. In effect, through a $140 contribution to the purchase and installation of an immobilizer, an interest-free loan for the balance and the continuation of the $40 annual premium credit, MPI has provided motorists with the opportunity to equip their vehicles with immobilizers at no cost to themselves.

MPI considered it necessary to go this far in its approach because of its conviction that 90% of Winnipeg passenger cars and light trucks will need to be equipped with immobilizers before the theft problem can be effectively addressed. (While MPI has identified the "top 100" vehicles subject to theft, for the program to be effective all vehicles need to have immobilizers installed, and hence the offer to all motorists.)

MPI's theft suppression pilot project involves the Department of Justice, the Corrections branch and the Winnipeg Police Service. Through vigorous enforcement of parole requirements, it is hoped that the worst young offenders can be more effectively managed and future theft experience reduced. While thefts were reported to be down this year by 14%, it is unclear how much of that reduction is due to the suppression project. The costs of the suppression project are recorded as expenses in the year incurred. In any case, the early indications arising out of the effort are encouraging.

MPI has revised its Basic Retained Earnings format to make its investment in the immobilizer program fully transparent. It has allocated $40 million of Basic Retained Earnings to the Immobilizer Incentive Fund (IIF), with the balance to continue as RSR. As expenditures are incurred, the IIF will be reduced by these amounts. MPI's business case forecast for its anti-theft initiative estimates the program will realize over $80 million in claim cost reductions over the term of the initiative, this as compared to the $40 million of anticipated costs set aside in the IIF.

The Board is concerned that the success of MPI's anti-theft initiative is dependent on a substantial participation rate, i.e. a substantial rate of voluntary installations of immobilizers. Some owners who do not take up the offer will own vehicles that have a higher risk of being stolen. The Board finds the risks associated with auto theft so high, with respect to financial, injury and social elements, that if the voluntary program is not successful, the Board will encourage MPI to consider stronger measures for non-participating vehicle owners.

The Board notes that there is evidentiary support for taking stronger measures if the voluntary program is not effective. MPI presented evidence at the hearing that the “top 100” vehicles susceptible to theft were generating claims costs in excess of premiums and that their premiums were substantially subsidized by the premiums on other vehicles. If the voluntary program does not bring about the desired take-up result, the Board would consider an application by MPI to attach surcharges on vehicles without immobilizers, this for future consideration.

Loss Transfer Decision

Responding to a decade of controversy and regulatory costs associated with CMMG’s opposition to motorcycle premium increases and the claims attribution model that supported the increases, the Board held a special hearing this spring. Testimony was heard and evidence received from Interveners, witnesses, including Ontario’s regulatory body, and MPI.

Arising out the hearing was the Board’s decision that directed changes to MPI’s claims attribution model to affect rate determination for 2007/08. MPI was asked to take into account any preliminary indications of rate direction arising out of the Board’s decision in proposing rates for 2006/07.

The Board-directed changes will result in a claims attribution approach sharing the costs of claims between the vehicle classification and groups involved in an accident. Single-vehicle claims attribution will remain as it is, to the classification and group of the vehicle involved. Preliminary indications of the rate implications arising out of the Board’s claims cost attribution decision, as reported by MPI at the October hearing, suggests that that the actuarially indicated rate for the motorcycle class will decline while commercial class premiums will rise.

MPI stated that, despite the to-be-implemented revised claims attribution model, overall motorcycle premiums remain under-assessed and a significant further rate increase is required for lower-rated rate groups, so as to bring overall motorcycle class revenue to revenue-sufficiency. No actuarially or other specific evidence was provided in support of MPI's assessment of the effect of the changes in the claims attribution model.

The Board also heard continued concerns expressed by CMMG with respect to the effect of the on-going higher-than-expected proportion of single-vehicle motorcycle accidents of all motorcycle accidents on motorcycle rates. The Board notes that its new claims attribution model direction leaves the approach to single-vehicle accidents as it is now, and has some concern that the approach may be resulting in undue pressure on motorcycle rates.

The Board will direct MPI to undertake detailed research to determine the causal factors of motorcycle and other single-vehicle accidents, towards determining to what degree the costs incurred should be shared among all vehicle classes. The Board is particularly interested in cases where the claim includes a representation that another unidentified vehicle was involved as a causal factor in the accident and the investigation accepts the representation. In such cases, the question is: while the charge against the motorcycle owner for the deductible may be waived, will the claims cost arising out of the accident be shared with other major classifications as preferred under the new methodology?

Given its reservations with respect to the quantum of the effect of the new claims attribution model on motorcycles and its questions with respect to the attribution of single-vehicle accidents, the Board will direct MPI to limit the average increase in motorcycle premiums for 2006/07 to 5%.

Planned Corporate Reviews

MPI plans to review the operations and design of PIPP, the Bonus/Malus system and all DVL and related Basic administrative functions. The Board encourages and supports a thorough review of these operational segments, towards achievement of:

a) customer service improvements;
b) reductions in accident severity and frequency; and
c) contained and reduced operating costs.

The annual rate hearings since the introduction of PIPP have continued to note on-going and significant increases in PIPP claim costs, understandable in large part as the PIPP segment expands over time and the remaining pre-PIPP tort claims are resolved. The Board notes MPI's latest indication that it plans to enhance its claims analysis capacity and practices, and therefore encourages and expects it to follow through prior to the next GRA.

As well, the Board notes the "Baron Report" which was filed at this year's hearing. The report by an independent actuary considered whether PIPP experience since the program's inception in 1994 was consistent with the 1993 forecast made prior to program commencement. Ms. Addie, the author of the report, concluded "The overall estimate is remarkably close to the actual experience of MPI under PIPP." While the Baron Report provides a degree of comfort to the Board, the Board-directed operating review to establish benchmarks and analyses to guide PIPP management is still necessary.

In Order 148/04, the Board commented on the introduction of red light cameras in Winnipeg, and the fact that violations do not result in demerits and surcharges on the owner's license, though fines are imposed upon vehicle owners under the Highway Traffic Act. Police-issued violations have decreased by over 50% since 1992, while the number of accidents and injuries in Manitoba remain high compared to other provinces.

All of this continues to suggest a need for MPI to revise the Bonus/ Malus system, and at this year's hearing MPI repeated its promise of a year ago that it would undertake a review now that DVL functions are within its control. The Board supports MPI in its plan to review and amend the Bonus/ Malus system, and, once again, encourages it to seek the suggestions and comments of the Interveners prior to doing so. The Board will again direct MPI to provide a report to the Board for the next GRA, reviewing its progress in its review initiatives.

Investment Portfolio

The Board is concerned with the prospects for future investment yield, a major contributor to restrained premium rates, with the current investment asset mix of MPI's investment portfolio. Accordingly, the Board will reiterate its recommendation to MPI that the asset mix be reviewed and further diversification entertained. As well, the Board remains concerned with MPI paying investment fees to the Province based in part on investments in Province of Manitoba securities.

Pursuant to legislation, MPI's investment portfolio is formally entrusted to and managed by the Department of Finance, Province of Manitoba. Nonetheless, MPI maintains an Investment Committee (of its Board of Directors), an Investment Working Committee (including Manitoba

Finance), and an Investment Department; the latter staffed with investment professionals. These committees and staff provide advice and guidance to the Department of Finance towards the management of the portfolio. With respect to the equity holdings, external investment managers manage the portfolio segment under contract to the Department of Finance.

The Department of Finance levies relatively modest annual fees of 0.075% and 0.03% of the fixed income and equity portfolios, respectively. While this longstanding levy is arguably modest, the levy is made on all securities, including the fixed income securities purchased from the Province. While applying the fees across-the-board has merit with its simplicity, on basic principle, the Board questions whether the Province should collect a management fee on investments it has made for MPI in province of Manitoba securities.

MPI suggests it has no expectation that it will break-even on its overall insurance operations without the investment income from its portfolio. In future, MPI expects the annual underwriting loss (revenue excluding investment income less operating, claims and claims related costs) will continue to increase, but be offset by rising investment income. Thus, future investment income is of critical importance to forecasts of future premium levels. Investment income is significantly influenced by MPI's asset mix, i.e., the distribution of its investment holdings between various kinds of investments.

MPI's investment asset mix continues to be heavily concentrated in fixed-income securities (bonds – primarily government, and short-term deposits). Equities comprise approximately 20% of the portfolio, and contain no foreign stocks other than traded stocks of American companies – and those holdings are restricted to no more than 5% of the overall portfolio. No other international stocks are held, nor any property or other security classes.

Because MPI's investments are concentrated on bonds, if current interest rate hold within a relatively narrow level range, MPI's holdings are unlikely to produce overall future annual yields to cover liability growth and to continue to support MPI's assumption for an investment yield of 5.75%. And, if rates were to rise, the market value of the bonds would fall. The Board notes not only that the MPI's pension plan investments are co-mingled with those related to insurance operations, but the actuarial yield assumption is far in excess of the likely net return of a portfolio so concentrated in fixed-income securities.

The Board is concerned that the portfolio as it is now structured may not generate the yields required by MPI to achieve its forecasts through and including fiscal 2009/10. The Board reiterates its suggestion of Order 148/04 that the asset mix be revisited

The Board notes that, at last year's rate hearing, MPI reported that it had engaged Mercers , an experienced actuarial and asset mix investment counsellor, to review the asset mix for its large investment portfolio. The Mercers Report recommended that:

(a) the portfolio should be further diversified from the reliance on bonds;
(b) the bond component invested in real return bonds should be increased; and
(c) diversification should include international non-U.S. equities and real estate.

The Board further notes that MPI rejected the advice of Mercers, offering four reasons:

a) a requirement to invest in Manitoba municipal, hospital and education bonds;
b) lack of experience in non-U.S. foreign stocks and real estate investments;
c) foreign exchange concerns; and
d) its portfolio mix earned more over the then-past five years than that recommended by Mercers.

The Board is of the view that MPI's portfolio is significantly large to allow for it to invest more in equities and diversify into other asset classes while still meeting its "invest-in-Manitoba" mandate. As well, it has the financial strength to obtain advice on other investment classes.

While the Board accepts MPI's report that other property and casualty insurers have investment asset mixes similar to that of MPI, the Board notes that MPI's PIPP benefit design provides for more assurance of long-term and large investment balances. As well, MPI's Crown Corporation status and the benefits arising from that provide solvency assurance not found with private insurers. The Board therefore recommends that MPI consider further diversification of the investment portfolio

In Board Order 148/04, the Board suggested that MPI discuss with the Province an exemption from the management fee levied by the Province with respect to MPI's investment in provincial bonds and short-term deposits, so as to eliminate one aspect of a perceived conflict of interest. The Board continues to recommend that MPI discuss with the Province exemption from investment management fees related to the portion of the portfolio invested in Province of Manitoba securities. While the sum collected by the Province through the levy on the portion of MPI's portfolio invested in its own security is not significant, an avoidance of a perceived conflict of interest through the elimination of this levy is preferred.

Claims Handling and Other Operating Expenses

The costs associated with Basic, excluding claims incurred, are claims expenses (costs related to claims handling services), road safety and loss prevention programs, operating expenses, commissions, premium taxes, appeal costs and regulatory expenses. MPI allocates these expenses between Basic, Extension and SRE based on approved allocation formulae.

In its Application, MPI projected costs for Basic Insurance as follows:

	Projected Expenses 2005/06 ($ millions)	**Projected Expenses 2006/07 ($ millions)**
Claims Expenses (Note 1)	67.9	72.1
Road Safety/ Loss Prevention (Note 2)	10.0	10.7
Operating Expenses (Note 3)	36.1	38.8
Commissions (Note 4)	33.5	34.8
Premium Taxes	18.9	19.7
Regulatory/Appeal Expenses (Note 5)	2.6	2.6
Total (Notes 6 and 7)	$169.0	$178.7

Notes:

1. Overall claims handling costs are allocated between Basic and Extension based on net claims incurred before financial provisions.
2. Three main priorities: occupant restraint, impaired driving and speed. Focus is on education, assistance for traffic safety programs administered by external agencies and general community work. Immobilizer program being funded from allocation of retained earnings.
3. Primarily employee compensation, Information Services related, telecommunications, occupancy costs and amortization of capital assets. Expenses allocated between Basic and Extension based on direct premiums written.
4. Brokers' commissions, increases primarily due to increases in premiums written. Commission expenses are and will be higher in 2004/05 and 2005/06 as a result of the cessation of approximately $6 million in commission offset payments by the Province. An anticipated "last recovery" of $1.5 million from the Province for the last quarter of 2003/04 was neither received nor now expected.
5. Public Utility Board process, Automobile Injury Compensation Commission, Crown Corporation Council, Advocate's Office and the Rates Appeal Board.
6. Expenditures for 2003/04 were $164.6 million.
7. Current outlook for 2009/10 was $203.4 million.

The annual rate of increase of non-claims incurred expenditures projected for the period 2003/04 through to and including 2009/10 is 4%, compared to the projected annual rate of increase for Net Premiums Earned for the same period of 5%. Annual increases in the Consumer Price Index are anticipated to be in the range of 2-3%. Annual volume increases in policies written are expected to be in the range of 1% to 1.5%.

The projections suggest a controlled and managed expense environment, though the Board is uncertain as to the effect of MPI's review of DVL and related Basic functions, which may result in costs moving from Extension into Basic, thereby increasing the rate of increase of Basic's annual expenses. Staff salary and staff growth, as well as Information System project costs potentially attributable to Basic, may rise as a result of this factor. On the other hand, since the expenses of DVL contribute to the forecast results of Extension and therefore reduce the potential contribution to Basic RSR, they are taken into account, albeit indirectly. The Board notes that as MPI reviews DVL operations while taking into account Basic functions, synergies are likely to arise.

Evidence presented at the hearing by CMMG compared increases in MPI's claims handling costs and operating expenses with increases in similar cost categories at SGI and ICBC. On a 2001 base, MPI's claims handling, operating expenses and commission expenditures increased by 29%, 21% and 48% respectively, over the three years, as compared to:

a) much lower SGI increases of 12%, nil and 35% over the same period; and
b) ICBC's recorded decreases in all expense categories, except for a marginal increase in commission expenses between 2001 and 2003.

While the large difference with respect to MPI's commission expense experience can be accounted for by the loss of the annual provincial commission offset of approximately $6 million, explanations for the remaining variances were not provided.

The Board continues to recommend that MPI benchmark its expense experience against other public insurers such as ICBC, SGI and Quebec's SAAQ. Benchmarking continues to represent best practice. Through it, informed views may be developed with respect to cost control and other matters such as road safety and loss prevention initiatives. Benchmarking requires not only an awareness of cost experience in other jurisdictions, but also an informed view on the factors driving the differing experiences.

Mopeds

At the hearing, the Board noted a willingness of MPI to work with Scootering Manitoba to distinguish between private-use owned mopeds and mopeds held in rental fleets. The Board recommends that MPI act on its inclination and work with the Intervener to improve the fairness of its approach to mopeds.

Inter-Provincial Trucking

The Board notes MPI's report that it has been incurring PIPP costs averaging in excess of $1 million with respect to inter-provincial truckers who are injured in accidents and file claims even though their vehicles are not assessed premiums that include a component for PIPP costs. With the now higher PIPP retention under MPI's reinsurance agreements of $3 million, the risk of even greater costs for such circumstances is present.

The Board notes MPI's confirmation that the current approach subsidizes trucking firms at the cost of other vehicle owners and suggests that MPI explore with the Province options to continued subsidization.

The Board is aware that though the subsidization may appear inequitable to other policyholders, alternatives may have problems as well. PIPP provides benefits to Manitoba motorists wherever they are driving in North America. Thus, if an inter-provincial Manitoba-based trucker is injured in either Manitoba or another province while driving a truck licensed in another jurisdiction, PIPP benefits may still be extended to the trucker. In such a case, the subsidization would still occur and the licensing of the truck and the fees associated therewith would be paid to another jurisdiction. In short, the problem is complex.

Road Safety

Premiums would have a much greater chance of declining in future if the incidence and severity of injuries were reduced. Road safety measures are key to premium reductions, and benchmarks need to be developed to allow MPI to effectively assess its road safety actions and plans, particularly with new opportunities now available through the assumption and integration of DVL functions.

As well, the Board expresses concern with reduced traffic infraction enforcement in Manitoba. MPI is urged to consult with the RCMP, the Winnipeg Police Service and the Province to address perceived diminished enforcement. The incidence and severity of accidents and injuries remain far too high.

MPI reiterated its reports of past hearings that it works to improve road safety by leading or supporting initiatives in partnership with other key agencies. MPI's three main road safety priorities continue to be:

- Occupant restraint usage;
- Impaired driving; and
- Speeding.

MPI indicated that it has developed an estimate of the annual claims costs associated with impaired driving and that it is working to develop a similar estimate for speeding. By developing such cost estimates, MPI will be able to establish benchmarks to compare against experience as it amends its programs, including the new opportunities now available through its assumption of DVL functions.

The Board is pleased with MPI's report that graduated licensing has reduced the incidence and severity of claims of first-time drivers, and hopes that over time, and with improvements to the Bonus/ Malus system, the overall incidences of claim frequency and severity can be brought down.

The Board suggests that MPI commission an independent study of vehicle theft, accident prevention and driver education. A major anti-theft initiative is underway, though internally-driven and supported. With respect to accident prevention and driver education, MPI plans to review DVL functions in 2006. The Board accepts MPI's need to prioritize its reviews.

Environmental Matters

The Board concludes that the interplay between insurance and environmental principles is yet to be fully understood, and recommends that MPI conduct further research into environmental concepts. The Board notes MPI's perspective that, for it to employ environmental principles in ratesetting, it would look to direction from government.

The Board further suggests that environmentally friendly insurance concepts such as Pay-As-You-Drive-insurance, which was discussed in the October hearing, should be carefully considered, along with other initiatives to enhance sustainable development objectives.

4.0 IT IS THEREFORE RECOMMENDED THAT MPI:

1. Review the cost allocations between Extension and Basic, taking into account the appropriateness of Basic recovering from Extension a portion of the commissions paid to brokers for services performed by brokers for the Province’s account;
2. Further diversify the investment portfolio;
3. Update the Risk Analysis;
4. Commission an independent study of accident prevention and driver education;
5. Consult with the RCMP, the Winnipeg Police Service and the Province to address perceived diminished enforcement resulting from red light cameras;
6. Take into account red-light camera infractions in its reforms to the Bonus/ Malus system;
7. Develop claims handling, PIPP and other operating cost benchmarks, perform analyses comparing MPI experience with that of other comparable insurers and file a report with the Board at the next GRA providing the findings;
8. Reconsider its decision to include DVL operations within the Extension division, with a view to reallocating the operations of DVL to Basic Insurance;
9. Work with Scootering Manitoba to separate commercial and private use mopeds for rating purposes, and provide a report prior to the next year’s GRA;
10. Consider in more depth environmentally friendly insurance concepts such as Pay-As-You-Drive-insurance, along with other initiatives that would enhance sustainable development objectives; and
11. Discuss with government a discontinuation of investment management fees to the Province for the portion of the portfolio invested in Province of Manitoba securities.

5.0 BOARD DIRECTIVES:

BE IT ORDERED THAT:

1. MPI's proposed motor vehicle premiums and fees for the Basic Automobile Insurance Program for the year ending February 28, 2007 are approved, excepting that the average increase to motorcycle rates be held to 5%;
2. The RSR range for Basic Insurance for ratesetting purposes be reset to $65 million to $100 million and that the IIF be a component of RSR for purposes of assessing RSR adequacy;
3. MPI provide a premium rebate in 2006/07 to policyholders on record as of December 31, 2005 of 10% of the motor vehicle premiums paid for basic compulsory insurance during the 2004/05 insurance year: the rebate is to be paid separately from the premium collection process;
4. MPI provide an update to the Board at the next GRA of MPI's progress on:
   (a) its Business Process Review of DVL functions; and
   (b) the Bonus/ Malus system; and
5. MPI research the allocation of costs arising out of single-vehicle accidents to determine if deemed-legitimate claims of causal involvement of unidentified vehicle(s) are divided equally between all vehicles.

The Public Utilities Board

"GRAHAM F. J. LANE, C.A."
Chairman

"G. GAUDREAU, C.M.A."
Secretary

Certified a true copy of
Order No. 150/05 issued by
The Public Utilities Board

Secretary

Appendix A

Appearances

W. S. Saranchuk, Q.C. C. Everard	Counsel for The Manitoba Public Utilities Board
K. McCulloch	Counsel for Manitoba Public Insurance Corporation
P. Shaw	Representing the Canadian Automobile Association (Manitoba Division)
R. P. Oakes	Counsel for the Coalition of Manitoba Motorcycle Groups
B. Williams	Counsel for the Consumers' Association of Canada (Manitoba) Inc./ Manitoba Society of Seniors
M. Scurfield	Representing the Insurance Brokers Association of Manitoba
R. Dawson	Counsel for the Manitoba Bar Association
C. Sousa	Representing Scootering Manitoba
N. Roberts	Representing Manitoba Used Car Dealers Association

Appendix B

Witnesses for MPI

M. J. McLaren	President and Chief Executive Officer
B.W. Galenzoski	Vice-President, Corporate Finance
W. Bedard	Vice-President, Claims
D. Palmer	Chief Actuary and Director, Pricing and Economics

Witness for CAC/MSOS

J. G. Todd	Elenchus Research Associates

Appendix C

Interveners

Canadian Automobile Association - Manitoba Division

Coalition of Manitoba Motorcycle Groups

Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors

Insurance Brokers Association of Manitoba

Manitoba Bar Association

Manitoba Used Car Dealers Association

Scootering Manitoba

Presenters

J. Stefaniuk

P. Zubrycki

L. Chartrand

P. Miller

R. Booker

M. Bay