MANITOBA	Order No.156/06
THE PUBLIC UTILITIES BOARD ACT	
THE MANITOBA PUBLIC INSURANCE ACT	
THE CROWN CORPORATIONS PUBLIC REVIEW AND ACCOUNTABILITY ACT	November 20, 2006

Before: Graham Lane, C.A., Chairman
Leonard Evans, LL.D. (Hon.), Member
Eric Jorgensen, Member

MANITOBA PUBLIC INSURANCE: COMPULSORY 2007/08 DRIVER AND VEHICLE INSURANCE PREMIUMS, PREMIUM REBATE, AND OTHER MATTERS.

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Glossary of Acronyms and Terms

Basic	Compulsory motor vehicle insurance
Bonus/Malus	Incentives and penalties to encourage good driving experience and behaviour
BPR	Business Process Review
CAA	Canadian Automobile Association
CAC/MSOS	Consumer's Association of Canada/ Manitoba Society of Seniors
CMMG	Coalition of Manitoba Motorcycle Groups
DCAT	Dynamic Capital Adequacy Test
Driver Safety Rating	Intended replacement for the Bonus Malus program
DVL	Driver and Vehicle Licensing
ERP	Equity risk premium (equity investments)
Extension	Optional motor vehicle insurance
GHG	Green House Gas
GRA	General Rate Application
IBC	Insurance Bureau of Canada
IBNR	Incurred but not reported
ICBC	Insurance Corporation of British Columbia
IIF	Immobilizer Incentive Fund
MBA	Manitoba Bar Association
MCA	Manitoba Chiropractors Association
MCT	Minimum Capital Test
Monopoly	Policies that can only be sold by a particular corporation/MPI
MPI	Manitoba Public Insurance Corporation
MUCDA	Manitoba Used Car Dealers Association
Near monopoly	Description of market domination in a competitive market due to distribution and other advantages by an insurer/MPI
No fault	Accident benefits not related to the fault of the driver
OSFI	Office of the Superintendent of Financial Institutions (federal)
PfAD	Provision for Adverse Deviation (an element of Unpaid Claims)
PIPP	Personal Injury Protection Plan
RCM/TREE	Resource Conservation Manitoba/ Time to Respect Earth's Ecosystems
RSR	Rate Stabilization Reserve
SAAQ	La Société de l'assurance automobile du Québec -
SDA	Sustainable Development Act (Manitoba)
SGI	Saskatchewan Government Insurance
SM	Scootering Manitoba
SRE	Optional Special Risk Extension motor vehicle insurance
Top 150	Makes and models of passenger vehicles more frequently stolen
Tort system	Benefits paid take into account the allocation of fault
Total no fault	Benefit approach that does not account for the fault of the driver
VAR	Value at Risk
WATSS	Winnipeg Auto Theft Suppression Strategy
WPS	Winnipeg Police Service

1.0 EXECUTIVE SUMMARY

This Order arises out of an application filed by Manitoba Public Insurance (MPI) for Basic premium rates and fees for the fiscal and insurance year 2007/08; a public hearing was held to review the application in October 2006. The Public Utilities Board (Board) has jurisdiction over rates and service of the compulsory basic motor vehicle insurance program operated by MPI, but not of Extension and SRE lines.

By this Order, the Board accepts MPI's proposals for an overall 2.6% decrease in Basic premiums, fees and discounts for 2007/08, <u>except as follows</u>:

a) the Board directs MPI to provide a premium rebate of 10% to all policyholders who paid basic compulsory insurance premiums in the 2005/06 insurance year, net of premium refunds and fleet rebates; and

b) the Board directs MPI to amend, without affecting premiums for any other class or vehicle, its proposed premium changes so as to:
    i) reduce the average increase in motorcycle rates to 5%, rather than the proposed 8.4%; and
    ii) cap increases in moped premiums at 25%, while retaining the 20% cap for increases for other vehicles (no cap is to apply for decreases to motor scooter premiums).

By these changes, the average premium decrease will be marginally more than the 2.6% proposed by MPI.

MPI opposed the approximate $60 million rebate to policyholders now ordered herein by the Board. The second rebate in as many years, and third in five years, reflects recent favourable financial results, brought about by a decline in claims expenditures from the forecast and higher than expected investment income. Notwithstanding opportunities that lie in the future to reduce accidents and claims expenditures, rebates should not be considered the norm.

The aggregate of MPI's Rate Stabilization Reserve (RSR) and Immobilizer Incentive Fund (IIF) exceeds the Board's target range. While MPI sought to increase the RSR target range to further provide for an event or a combination of events depleting RSR that may arise in the future, the Board is satisfied that its current RSR range is adequate. Furthermore, the Board expects that most policyholders, including those represented by interveners to the recent hearing, understand there is no guarantee that average premium rates will never rise in the future, regardless of the level of the RSR, for which the Board resets a range of $69 million to $105 million.

The reduction to MPI's proposed increase for motorcycles is in lieu and in advance of the application of the 2005 Board-directed change to MPI's claims allocation methodology to collision claims. Capping the increase to moped rates is consistent with previous Board directives, though the cap set is 5% higher, reflecting the relatively low level of average premiums for this group. The large decreases for motor scooters proposed by MPI and concurred in by the Board are required to correct an inequity; registered motor scooters are few in number.

Leaving aside the rebate, average premiums in 2007/08 for major vehicle classes will change from the levels of 2006/07 as follows:

a) private passenger vehicles - an average 3% decrease ;
b) commercial vehicles – an average 5.4% increase;
c) public service vehicles – an average 2.4% decrease;
d) trailers – an average decrease of 14.1%;
e) off-road vehicles – no change; and
f) motorcycles – an average increase in the range of 5%.

The Board supports MPI's anti-theft initiative, considering it and the upcoming Driver Safety Rating System project to represent the keys to the prospects for future motor vehicle premium reductions.

Towards ensuring the success of the anti-theft initiative, the Board would be receptive to a subsequent application from MPI seeking premium surcharges for vehicles on MPI's "top 150" most at risk (of being stolen) list without immobilizers. MPI is to monitor the take-up rate for its current voluntary immobilizer offer and consider making an application for surcharges upon concluding a successful program is unlikely to result without surcharges.

In the Board's view, motor vehicle accidents and injuries continue at unacceptable levels, and the Board looks forward to substantial future reductions to arise out of MPI's plan to replace the existing bonus/malus approach (whereby good driving experience is rewarded and poor experience punished) with a more effective program. With improved incentives and larger financial penalties with respect to driver behaviour and experience, and given success in reducing auto theft, opportunities for future premium reductions exist.

While finding MPI well managed and its Basic insurance program of continued benefit to policyholders, developments at recent annual hearings require the Board to urge government to extend the Board's oversight to include MPI's Extension and SRE divisions. The policyholders of Extension and SRE are also the policyholders of the Basic program, and the linkages between the programs require and would benefit from comprehensive regulatory oversight. The actions and stated intentions of MPI suggest that for effective regulation and protection of policyholder interests, broader Board jurisdiction is required.

Also in this Order, the Board makes a number of recommendations to MPI intended to lead to improvements in operations and understandings. These recommendations pertain to a wide range of subjects, ranging from investment matters to operating benchmarks and environmental sustainability.

The Board expresses its appreciation of MPI's contributions throughout the hearing process; without the co-operation, transparency and openness of its witnesses, the Board's regulation of MPI's rates and service would be unduly difficult.

2.0 INTRODUCTION

Rate Hearing Process

MPI applied to the Board for approval of 2007/08 premiums for compulsory vehicle and driver insurance under its Basic Automobile Insurance Plan (Basic). MPI's operations are divided into two main segments:

a) Basic, that is regulated compulsory insurance, operated as a monopoly, and
b) Unregulated and competitive lines of business [Extension and Special Risk Extension (SRE)].

While MPI reports having in excess of 88% of the market for the competitive lines, giving it what was described at the hearing as a "near or virtual monopoly", Board jurisdiction over rates and service is restricted to Basic compulsory insurance, which is operated as a monopoly.

The evidentiary component of the Board's hearing of MPI's application for approval of base rates and premiums charged for a compulsory vehicle and driver insurance (Basic) proceeded with a public hearing extending over three weeks in October 2006concluding with final statements by MPI and hearing interveners.

The process followed was pursuant to *The Crown Corporations Public Review and Accountability Act, The Public Utilities Board Act, and The Manitoba Public Insurance Corporation Act*.

Interveners to the process included:

a) Canadian Automobile Association – Manitoba Division (CAA);
b) Coalition of Manitoba Motorcycle Groups (CMMG);
c) Consumers' Association of Canada (Manitoba) Inc./Manitoba Society of Seniors (CAC/MSOS);
d) Manitoba Bar Association (MBA);
e) Manitoba Chiropractors Association (MCA);
f) Manitoba Used Car Dealers Association (MUCDA);

g) Resource Conservation Manitoba/Time to Respect Earth's Ecosystem (RCM/TREE); and

h) Scootering Manitoba (SM).

In addition to the interveners, there were a number of individual presentations made to the Board expressing particular concerns. Presentations are not evidence, and presenters express views that are not subject to cross-examination, thus the contribution of presenters is constrained. MPI is expected to provide a response to each presenter, with copies to the Board.

This Order provides the Board's findings, recommendations and directions on matters of interest arising in the course and out of the hearing process, as referenced through testimony at the hearing or filed documentary evidence. Hearing transcripts are posted on the Board's website, www.pub.gov.mb.ca/mpitrans.html, and provide public access to the full record of the hearing, including cross-examination of MPI witnesses by the Board and by interveners, as well as to past Board Orders. Exhibits placed on the record at the hearing may be viewed at the Board's offices. Interested parties may peruse MPI's Annual Report and quarterly financial statements, which may be found on MPI's website (http://www.mpi.mb.ca).

Basic Background

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

1. providing universal mandatory motor vehicle insurance;
2. providing lower premiums than private insurers for, at minimum, comparable coverage and service;
3. returning at least 85% of premium revenue in claims benefits;
4. supporting Manitoba infrastructure through investments in municipal, hospital, education and provincial bonds;
5. providing superior automobile insurance coverage and service;
6. providing responsive, fair, courteous and convenient customer service;
7. providing an adequate RSR;

8. providing an internal working environment attractive to productive improvement-minded people;
9. treatment of employees with respect and fairness;
10. leading initiatives on driver education and training; and
11. addressing risky driving behaviour.

<u>Program Amendments</u>

While the degree of success in meeting these objectives may be argued by some, MPI's commitment to succeeding in meeting them has been evidenced annually in the Board's public hearing processes.

Since MPI's inception there have been several amendments made to its offerings, insurance product design and practices. Very early in its existence, the Extension and SRE lines of business were added, along with general property, liability and reinsurance assumed. Following a major loss on operations in 1985/86, MPI sold its general property and liability insurance operation and discontinued accepting reinsurance risks. At about the same time, MPI increased Basic deductibles significantly and implemented a bonus/malus program, which it now plans to replace with the Driver Safety Rating program.

There have also been basic benefit design changes, the most important being the 1994 adoption by legislation of "total no fault" benefits, an approach initially recommended by Judge Robert Kopstein (Autopac Review Commission, 1988). The Personal Injury Protection Plan (PIPP) provides compensation, medical and rehabilitation benefits to those injured in motor vehicle accidents regardless of fault. Subsequently, PIPP was amended to include a retirement income benefit. And, through a Board Order arising out of a special public hearing held in the spring of 2005, the concept of "no fault" was extended to the attribution of PIPP costs to vehicles involved in accidents.

With respect to efforts towards beneficially influencing the level and severity of claims, MPI has become increasingly active. Through driver education and training, the introduction of graduated licensing, support provided to the Winnipeg Police Service (WPS) and Manitoba Justice, the immobilizer program, and now, the planned advent of a restructured bonus/ malus program, MPI seeks to reduce claims, accidents, injuries and fatalities. Auto theft gradually became a major social and economic problem in Manitoba, and, despairing as to the risk of even higher costs to be borne by policyholders and other social ills, MPI introduced the immobilizer incentive program. Recent amendments to the program are:

a) free installations for vehicles considered by MPI to be most at risk of theft;
b) by regulation, the requirement for recovered stolen vehicles to have immobilizers installed prior to being returned to service; and
c) by regulation, the requirement that car dealer imported used vehicles have immobilizers installed prior to registration.

<u>2007/08 Basic Application</u>

MPI sought Board approval for an overall premium decrease of 2.6 percent for Basic policyholders, though increases and decreases would vary considerably dependent upon vehicle and driver experience.

In developing its rate proposal, MPI employed experience based rate adjustments ranging from minus 15 percent to plus 15 percent for individual vehicle classes, with exceptions for mopeds, trailers with a value of $2,500 or less, and off-road vehicles. For all vehicles other than motorcycles, trailers and off-road vehicles, MPI also included in its proposed rates, classification offset adjustments ranging from minus 3.3% to plus 11.1%, this to achieve revenue neutrality arising from rate group adjustments and securing an overall 2.6% average decrease. In its proposal, MPI capped all rate changes at 20%, except for increases for mopeds and decreases for motor scooters of 94.8% (increase) and 73.2% (decrease), respectively.

MPI proposed average rate adjustments for each major vehicle class as follows:

a) for private passengers vehicles, a 3% percent decrease;
b) for commercial vehicles, a 5.4% increase;
c) for public service vehicles, a 2.4% decrease;

d) for motorcycles, a 8.4% increase;
e) for trailers, a 14.1% decrease; and
f) for off-road vehicles, no change

Proposed motorcycle rates were positively impacted by the 2005 Board-directed change in claim attribution; premiums for commercial vehicles were negatively impacted. After consideration of insurance use, territory, capping and balancing for experience rate adjustments, MPI projected impacts on vehicles as follows:

a) 74.5% to receive a rate decrease (most decreases proposed to be less than $50);
b) 6.2% to remain at 2006/07 levels;
c) 13.2% to receive a rate increase of up to $20;
d) 4% to receive an increase between $20 and $50;
e) 1.4% to receive an increase between $50 and $100; and
f) 7% to receive an increase greater than $100.

The Board’s direction herein will result in fewer vehicles, specifically motorcycles including mopeds, incurring large increases.

The insurance portion of the Driver's licence premium was proposed to remain unchanged at $45. (The licensing fee component, set by and remitted to the Province, also remains unchanged). Service, transaction, permit and certificate fees were proposed not to change.

MPI based its proposal on its forecasts for revenue, claims and operating expenses. While rate increases have been infrequent since PIPP was introduced, MPI’s annual revenues from policyholders have continued to increase. Vehicle upgrades and increased numbers of insured vehicles provide MPI with annual revenue increases. From the upgrade and volume factors alone, MPI consistently projects 5% annual premium revenue growth, and this was again the case with this year’s application.

MPI projected total earned revenues for 2007/08 of $684.2 million, compared to $665.2 million now forecast for fiscal 2006/07, including $18.1 million of service fees in 2007/08, a 20%

increase from the $15.8 million forecast for 2006/07. In addition, Basic's share of overall investment income was projected to be $84.0 million.

The aggregate of claims incurred, claims and road safety expenses, and loss prevention expenses were projected by MPI to increase in 2007/08 to $674 million from $646.8 million for 2006/07, an increase of 4.2%. MPI also projected operating, commission, tax and other 2007/08 expenses of $100.6 million, an increase of $3.1 million, or 3.2%, over projected 2006/07 expenses.

Deducting projected expenses from projected 2007/08 revenue, MPI projected a Basic underwriting loss for 2007/08 of $90.4 million, to be offset by projected investment income of $84 million and a further transfer from the IIF to arrive at a projected modest surplus.

Claims incurred, injuries and property damage, is MPI's largest annual cost. Claims experience rate adjustments are a major factor in determining vehicle premiums, and are developed considering historical data and projecting results into the future to determine the expected cost of claims for all vehicle categories. Overall, the adjustments are applied so as to achieve revenue neutrality, i.e. experience adjustments did not alter the proposal for a 2.6% average premium reduction.

Net claims incurred (claims incurred less recoveries including reinsurance) represent results and expectations for several claim categories. PIPP claims incurred for 2005/06 were $194.5 million, and the forecasts for 2006/07 was $226.2 million, and for 2007/08, $237.3 million. MPI's external actuary, James Christie, advised that MPI's claim development experience was stable, i.e. fluctuations from year to year were within acceptable ranges, supporting forecasts based on past experience.

Claims incurred with respect to collision coverage were $207.3 million for 2005/06, and were projected to rise to $228 million for 2006/07 and $241.1 million for 2007/08. Claims incurred for comprehensive coverage were $68.3 million for 2005/06, and were projected to decrease to $62 million for 2006/07 then falling further to $60.6 million for 2007/08, the drop recognizing an expectation of gradually reducing the auto theft experience.

Overall, net claims incurred for 2005/06 were $520.9 million, with forecasts for $557.5 million for 2006/07 and $582.4 million in 2007/08. Thus, aggregate net claims incurred are projected by MPI to increase by 7.0% in 2006/07 and 4.4% in 2007/08, 11.8% over the two years ending February 28, 2008. MPI presented evidence of claim costs control measures for bodily injury (PIPP) and all perils.

In its Application, MPI projected Basic program expenditures other than incurred claims costs of:

	Projected Expenses 2006/07 ($ millions)	**Projected Expenses 2007/08 ($ millions)**
Claims Expenses (Note 1)	69.8	71.9
Road Safety/ Loss Prevention (Note 2)	19.5	19.7
Operating Expenses (Note 3)	39.4	41.4
Commissions (Note 4)	34.5	36.1
Premium Taxes	19.7	20.5
Regulatory/Appeal Expenses (Note 5)	3.3	3.4
Total (Notes 6 and 7)	$186.7	$193.0

Notes:

1. Overall claims handling costs are allocated between Basic and Extension based on net claims incurred before financial provisions.
2. Now classified as claims expenses, road safety has 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. The Immobilizer program is funded from an allocation of retained earnings (2004/05 and 2006/07), with credits against actual period expenditures.
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, though significant increase from 2004/05 as a result of the cessation of approximately $6 million in annual commission offset payments by the Province (DVL related).
5. Public Utilities Board process, Automobile Injury Compensation Commission, Crown Corporation Council, Advocate's Office and the Rates Appeal Board.
6. Non-claim expenditures for 2005/06 were $ 171.1 million.
7. Current outlook for 2010/11 is $ 206.1 million.

The projected annual rate of increase for non-claims incurred expenditures for 2006/07 through to and including 2010/11 approximates 4.1% compared to the projected annual rate of increase for Net Premiums Earned for the same period of 4.3%. Annual increases in the Consumer Price

Index were projected by MPI to be in the range of 2% to 3%, while annual volume and upgrade increase factors would be 1.5% and 3.5%, respectively.

An increase in claims expenses of 23% over 2005/06 is projected for 2006/07, driven by a change in categorization with respect to road safety costs, with a further projected increase for 2007/08 of 1.93%. Operating expenses attributable to the Basic program are projected to increase to $39.4 million in 2006/07 from $36.8 million in 2005/06, and are projected to increase further to $41.4 million in 2007/08.

MPI's safety initiatives continue with a focus on three main priorities:

a) occupant restraint/seatbelt usage;
b) impaired driving prevention; and
c) unsafe speed.

The largest projected road safety expenditure in 2006/07 relates to anti-theft strategies, with Basic's allocated share for road safety projected at $12.3 million. CAC/MSOS gave considerable attention to seeking amendments to MPI’s road safety initiatives, beginning with completion of a long-planned analysis of the annual cost to MPI arising out of driver and occupant failure to use seatbelts, impaired driving and speeding. CAC/MSOS contended that without an understanding of the cost drivers from a driver behaviour failure perspective, it would be difficult to set objectives or targets to achieve for road safety programming, though such benchmarks were required.

One of CAC/MSOS’ suggestions to MPI was that a report on graduated licensing experience to-date be prepared and filed with the Board, and the hours of required actual instructor accompanied driving by drivers-in-training be increased. CAC/ MSOS also questioned MPI’s approach to elderly drivers, citing an ICBC study that reported that the *55 Alive* program, though in-place to reduce claims experience with the elderly, had actually led to worsened experience by falsely inflating some elderly drivers’ perceptions of driving capabilities. CAC/MSOS suggested improvements were required to the program reflecting B.C.’s findings.

MPI reported on its current undertaking to implement a new system to replace the current bonus/ malus system, this to be the subject of a special Board hearing next spring. The cost of this initiative was forecast at $7.4 million, with an additional $1.7 million to be set aside as a contingency provision. MPI targets implementation by August 1, 2008, following a special Board hearing on the topic, and expects to transition all drivers to the system by July 1, 2009.

Capital project costs are incurred on a regular basis, and MPI reported that its main capital project is the Business Process Review (BPR), which includes the aforementioned Driver Safety Rating program. The BPR initiative has been provided a budget through 2008/09 of $28.7 million. Essentially, the BPR is to identify service improvements and cost reductions to be accomplished by amending MPI's current business practices; included is the integration of DVL functions within MPI's overall operations. The allocation of capital expenditures to Basic for 2006/07 was projected to be $15.5 million.

MPI's expenditure projections suggest a relatively controlled Basic program expense environment, though the Board is uncertain as to the eventual impact from MPI's BPR project. The Board expects costs will "move" from Extension into Basic as Basic and DVL functions are integrated, thereby increasing the rate of increase of Basic's annual expenses. This may particularly be the case with respect to staff compensation and Information System project costs.

On the other hand, since DVL net expenditures depress annual Extension net income, if DVL costs are reduced over time and the transfer of Extension retained earnings to the RSR resumed, any negative impact on Basic to arise from the integration of Basic and DVL functions would be reduced. On this matter, the Board noted MPI's indication that if the RSR were to fall below the minimum of the range allowed by the Board, excess retained earnings transfers from Extension and SRE would be considered to avoid premium surcharges, if such were under consideration.

Interveners CMMG and SM objected to MPI's rate proposals for motorcycles and mopeds. MPI requested approval of an exception to the absolute 20% increase cap established by Board Order 150/05. By MPI's proposal, a 94.8% average premium increase would apply to 2007/08 moped premiums, resulting in 91% of moped owners incurring an increase of no more than $100 with the largest increase being $118. As well, premium increases of $100 or more would have been incurred by sport bikes. (Board direction herein will lessen these estimates.)

MPI has been phasing in rate line adjustment for motorcycles over the last several years, a process proposed it proposed would be completed in 2009/10. MPI's premium proposals for 2007/08 reflected the effects of the Board's decision last year with respect to attributing claims, a decision that has resulted in lower required rate increases for motorcycles and higher increases for commercial vehicles. All other classes were, on average, essentially unaffected by the change.

MPI proposed to continue allocating no share of its operating costs to trailers and off-road-vehicles, this on the basis that an allocation of operating costs would produce rates based more on operating costs than claims incurred. That said, it does create an anomaly, vehicles with a "free ride" with respect to having any share of responsibility for operating costs.

MPI has acted on a 2005 Board-direction and has separated rental mopeds from driver-owned mopeds; future experience will determine rate differentials. MPI also proposed the continuation of differentiation of sport motorcycle rates from other motorcycles; sports bike premiums were to be substantially higher than other motorcycles.

MPI confirmed at the hearing a continued general policyholder annual subsidy of inter-provincial trucking of approximately $1.8 million; these vehicles incur PIPP costs which are neither recovered nor reflected in premiums. In response to a 2005 directive of the Board to provide options to counter the subsidy, MPI advised it was unaware of any feasible steps that could be taken to end the subsidy, which is in place through provincial regulation for general economic development reasons.

<u>Sustainable Development</u>

With respect to sustainable development, MPI reported on its efforts to promote sustainability with respect to its internal operations, though indicating it would require government direction before considering employing its premium setting model to advance sustainability. However, MPI reported it would conduct research into the premium concept known as PAYD (Pay-As-You-Drive insurance), which has been employed in several jurisdictions in the western world. The advantages attributed to PAYD by its proponents include environmental benefits through reductions in discretionary driving and more equitable premiums for some motorists. The Board suggested that research be undertaken of the PAYD concept in its 2005 Order; MPI did not act ahead of this year's hearing due to other priorities.

MPI's Financial Situation and Prospects

In terms of its overall financial situation, MPI reported:

a) For the 2005/06 fiscal year, Basic insurance division net income of $88.6 million after a transfer from the IIF, compared to the updated forecast of last year of $53.8 million, the result representing an improvement of $34.8 million over the revised projection. MPI attributed the positive variance to lower than expected incurred claims ($10.4 million) and higher than forecast investment income ($26.9 million), the latter attributable to the equity component of MPI's investment portfolio.
b) For fiscal 2006/07, the current year still in progress, MPI forecast Basic net income of $34.7 million, including a $10.7 million transfer from the IIF. Prior to the transfer, MPI projected net income of $24 million, compared to the forecast of $416,000 at last year's hearing, including a $1.8 million transfer from the IIF. MPI attributed the improvement to projected increases over originally forecast investment income, now forecast to reach $103.1 million, an improvement of over $28.1 million compared to the initial forecast.
c) For fiscal 2007/08, the year to which MPI's application pertains, MPI now projects net income of $4.6 million after a transfer from the IIF of $11.1 million and assuming Board approval of the requested 2.6% average premium reduction. This projection represents an improvement from the $1.6 million loss projected last year, yet represents a substantial decline from MPI's actual and projected results for 2005/06 and 2006/07. That said, in recent years MPI results have been considerably better than its forecasts; the results for the six months ended August 31, 2006 were much better than expected.

Through to 2013/14, MPI forecasts savings attributable to its anti-theft initiative to accumulate to approximately $130 million, with annual savings in excess of $30 million to continue each year thereafter. In response to a question posed by the Board at the hearing, MPI's external actuary, James Christie agreed that if the savings were infinite as to duration, the projected net present value of the initiative would exceed $500 million. In other words, if MPI's projections for the anti-theft program are fully realized, average premiums for all vehicle classifications will decline, all other factors remaining the same.

MPI also acknowledged that if it amended its forecasts to take into account an annual equity risk premium (ERP) of 1.5% on its equity holdings, its 2007/08 investment income forecast for Basic operations would increase to $90.7 million, or $6.7 million higher than the current forecast of $84 million. (The nature of ERP is outlined later in this Order.)

Rate Stabilization Reserve (RSR)

A significant portion of the hearing was taken up by discussion concerning the adequacy of the RSR. Interveners shared a perspective that if MPI's RSR balance, including the IIF, is in excess of the Board's RSR range, a rebate to policyholders is required. MPI agreed that, when the RSR is above the Board's maximum, a rebate is warranted, but disagreed with respect to both the inclusion of the IIF in determining the actual balance of RSR and with the RSR range established by the Board.

Brought forward from the 2005 hearing, was the Board's RSR target range of $65 million to $100 million, to be inflated in accordance with the growth of Gross Written Premiums. Contrarily, MPI re-advanced its recommendation of last year that the RSR range be based on the outcome of applying the Minimum Capital Test (MCT), a test of an insurer's capital adequacy mandated by the federal Office of the Superintendent of Insurance (OSFI) for private insurers regulated by OSFI. MPI proposed a RSR target range of between $107 million and $214 million (being 50% and 100% of MCT, respectively).

MCT is intended to be calculated annually, to derive a ratio expressing an insurer's available capital to capital required. MCT employs OSFI-prescribed factors that are applied to historical or projected financial statement values. Through the DCAT (Dynamic Capital Adequacy Test) process, MCT results are compared between a base scenario and various adverse scenarios, as part of a process of determining an insurer's sensitivity to adverse scenarios.

MCT is primarily a test of solvency, as solvency is an ever-present concern for a private insurer and its regulator; inadequate capital may result in OSFI intervention. Intervention by the federal regulator may include restriction on the volume of policies to be written by an insurer to the forcing of the sale of business if an insurer's capital cannot be brought up to OSFI's required standard.

Why is OSFI concerned? Because policyholders depend on insurers to meet claims, businesses and families depend on the protection they have assured for themselves through their insurance policies. A private insurer has only the adequacy of its claims reserves and capital base to assure policyholders and the regulator that valid claims will be paid in a timely fashion.

Does the same concern exist in the case of MPI? MPI and interveners both say no, and the Board agrees (Order 150/05). For MPI, having an inadequate capital base would lead to higher premiums for future policyholders, policyholders that could not "go elsewhere" to obtain compulsory basic insurance. For compulsory basic motor vehicle insurance, MPI is the only market in Manitoba. Further, MPI has the government as its ultimate administrator, and the legislature as the originator and sponsor; no one involved in the hearing process argued that MPI was at any risk of insolvency. And, no adverse event capable of testing that view was advanced for consideration.

Since MPI is a monopoly and its basic insurance policy a requirement for vehicle owners, implementing rate changes to address a major adverse loss development is far less of a problem than in the private sector. A private insurer has to concern itself with the actions and potential reactions of competitors.

However, MPI's external actuary posited a risk, that being of a sharp and sustained increase in inflation, and suggested the potential that in such a situation there may not be a timely premium adjustment. While no party to the hearing supported "budgeting for a loss," MPI joined its external actuary in suggesting that a lag could occur between knowledge of a necessity for a material premium increase and implementation of the increase. MPI suggested such a delay could lead to rate shock when the need for higher premiums was addressed. Interveners expressed more confidence in the ability of MPI to respond to such a situation in a timely fashion, so as to avoid rate shock.

MPI also supported its case for the adoption of a MCT-based RSR by providing an updated Risk Analysis and VAR. This in response to Order 150/05 which suggested to MPI that if it were to pursue its interest in substituting a MCT-based test of RSR adequacy, an updated Risk Analysis and VAR, being the present analyses used by the Board in considering RSR adequacy, were required. However, MPI amended the assumptions underlying the analyses, prompting questions from interveners and the Board.

Much was said at the hearing as to the purpose of the RSR, as behind any proposal for a RSR range lies an understanding as to its purpose. While the name itself, RSR, implies a purpose, considerable discussion took place over the specifics implied and whether the purpose had changed. The Board will provide its perspective on this issue in the Board Findings section of this Order.

MPI posited that the purpose of the RSR is to protect motorists from premium increases made necessary by unexpected events and losses arising from non-recurring events or factors. MPI's position according to Ms. Marilyn McLaren, its President and CEO, was: *"If we were writing this today, we might write this to say that it's intended to protect motorists … from large special surcharges to rebuild the RSR made necessary by unexpected events and losses."*

MPI's statement of RSR purpose changed from the position taken by MPI in previous hearings, wherein the Corporation suggested the purpose of the RSR was to meet the cost of a catastrophic single event (an act of God), such as a major hailstorm or a flood. Different opinions were evidenced at the hearing as to whether the change in MPI's view was material or important for rate setting.

MPI's application projected RSR balances as of the end of fiscal periods ending February 28:

a) 2006 - $173.1 million (including the IIF balance of $37.1 million and $19.4 million in SRE and Extension transfers on March 1 – note, MPI does not include the IIF in its calculation of the RSR's operative balance);
b) 2007 - $197.1 million (including the IIF balance but without any current transfer of SRE and Extension retained earnings);
c) 2008 - $190.6 million (including the IIF, again without transfers from Extension or SRE);
d) 2009 - $185.5 million (including the IIF, with neither SRE or Extension transfers);
e) 2010 - $188.7 million (including the IIF, with neither SRE or Extension transfers); and
f) 2011 - $199 million (including the IIF, with neither SRE or Extension transfers).

MPI's summary of RSR actual and forecast positions and transactions from fiscal 2004/05 to fiscal 2010/11, as presented by MPI, follows:

Basic Insurance Rate Stabilization Reserve
($ millions)

Fiscal Years Ending February 28/29	**2005 actual**	**2006 actual**	**2007 proj.**	**2008 proj.**	**2009 oroj.**	**2010 proj.**	**2011 proj.**
RSR, opening balance	42.8	126.0	173.1	197.1	190.6	185.5	188.7
Net income (loss)	59.9	85.7	24.0	(6.5)	(5.1)	3.2	10.3
Premium rebate		(58.0)					
Prior-period adjustment	(10.6)						
Transfer from SRE	29.6	8.4					
Transfer from Extension	4.3	11.0					
Total RSR	126.0	173.1	197.1	190.6	185.5	188.7	199.0

Projected RSR balances from 2007 were negatively impacted by MPI's decision not to undertake further transfers of deemed excess retained earnings from Extension and SRE to the RSR unless the Public Utilities Board adopts its preferred RSR range of $107 million to $214 million. The higher range would effectively bar a premium rebate for the forecast periods, assuming all other factors as projected.

Coincident with MPI's change in intention as to transferring competitive line retained earnings to the RSR, and as another stark change from recent past applications, MPI declined to file any forecasts of future retained earnings balances related to SRE and Extension. In doing so, MPI cited the Board's limited jurisdiction. These actions reduce the prospects for the RSR and future premium rebates. And, with Basic operations generally designed to "break-even", the ability to rely on Extension and SRE retained earnings to support RSR adequacy was an important factor in the Board's direction to MPI to provide a 2006 rebate of 10% to Basic policyholders.

MPI's rationale for withholding excess Extension and SRE retained earnings from transfer to the RSR was based entirely on the prospect of a future rebate. MPI reported a concern that if the Board's lower RSR target range was retained while transfers of Extension and SRE retained earnings continued, the Board would likely rebate those transfers to Basic policyholders, an undesirable outcome from MPI's perspective.

With the debate over the adequacy of the RSR being one of the main issues at the hearing, the contrasting views of the Corporation and interveners as to the overall financial strength of the Corporation was of particular interest. MPI, commenting only on the Basic program, suggested the RSR balance was inadequate, while interveners, considering the overall financial position of MPI, took a contrary view, considering MPI's balance sheet as "strong."

With February 28, 2006 Extension and SRE retained earnings of $43.1 million and $47.2 million, respectively, and a RSR/IIF balance of $173.1 million, MPI's overall reserves at that date aggregated $263.5 million. Further, based on unaudited results as of August 31, 2006, the overall reserve balance on that date was in excess of $320 million. In its history, MPI has never reported a higher aggregate reserve balance.

MPI's present forecast for the ending balance of Basic RSR for 2007/08, being $190.7 million including the IIF but excluding the retained earnings of Extension and SRE, was well in excess of the maximum of the Board's RSR range. Unless the Board significantly increases its RSR range at the 2007 hearing, or current financial results worsen considerably, this suggests the potential for yet another rebate in 2008.

<u>Risk Analysis/ VAR – MCT/ DCAT</u>

At both the 2005 and 2006 hearings, MPI advocated for the adoption of a MCT-based target range for the RSR that, if adopted, would mean that the present balance of the RSR would be below the maximum of the range and no rebate to policyholders would be considered. It was advanced by MPI that its conversion to MCT, first evidenced at the 2005 hearing, was unrelated to the coincident event of the RSR exceeding the Board's target range.

The Board's RSR target as of the start of the 2006 proceedings was $65 million to $100 million, a range based on the Risk Analysis and VAR model, supported by assumptions accepted in earlier hearings. MPI's recommended RSR range of $107 million to $214 million is roughly twice the range established by the Board, and MPI's proposed range was supported by MPI's reliance on OSFI's MCT/DCAT-based approach.

Historically, the Board has reached its conclusion on the adequacy of RSR based on an evaluation of the specific risks faced by MPI, relying on two analyses:

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

b) Value at Risk Analysis (VAR).

The Board and interveners have relied on the two analyses for some time, with particular assumptions and methodologies employed, as did CAC/ MSOS's witnesses, Professors Hum and Simpson, at this year's hearing. The Board noted in Order 177/99:

> *" … 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."*

The Board then-stated *"... (the Board) expects that in the future, MPI will … use the methodology and statistical approach contained in the … Risk Analysis…."*

The Risk Analysis is a statistical approach devised by MPI to assess its operational risks; the VAR is also MPI-based and complements the Risk Analysis by providing an assessment of investment portfolio risk. According to the 2001 Risk Analysis, 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"*.

The Risk Analysis has been amended in the past (Board Orders 154/98, 177/99 and 151/00), and at this hearing MPI proposed further amendments. MPI's amendments would be not only to the Risk Analysis but also to the VAR, that is, if these analyses were to be retained as the basis for the determination of the RSR range.

MPI recommended:

a) updating claims incurred to reflect current price levels (the Risk Analysis utilizes historical data, that is not inflated to current price levels);
b) updating the terms and limits of reinsurance arrangements; and
c) with respect to the VAR, amending the investment performance forecast to a twelve-month horizon from the previous two and half-year perspective. (As well, MPI's updated VAR was based on the historical approach; the previous COMSTAT study used the variance/co-variance approach, arguably a more sophisticated method.)

By amending the approach, MPI's updated Risk Analysis and VAR suggested a much higher range for the RSR than the Board's then-present range, arriving at a revised range maximum much closer to the $214 million maximum proposed by MPI pursuant to a MCT-based approach.

Current higher reinsurance retentions replaced the lower levels of prior periods in MPI's updated Risk Analysis; claims incurred were indexed to reflect current values; and the time horizon for evaluating the risk of investment valuation fluctuations was shortened to one year from 2.5 years.

MPI regularly amends its reinsurance arrangements, though previous amendments have not led to a proposal to amend the RSR range. As to the growth in Unpaid Claims, evidence at the hearing indicated:

a) growth will continue until PIPP fully matures (i.e. the number of outstanding claims and the duration of outstanding claims stabilize); and

b) the risks associated with PIPP have not changed materially (the underlying data is relatively stable, and the primary remaining risk is a potential legislative amendment or Court decision materially expanding benefit entitlement).

Professors Hum and Simpson and interveners CAC/MSOS and CMMG, disagreed with MPI's proposals to modify the assumptions supporting the Risk Analysis and the VAR.

Based on the results of a Risk Analysis/VAR utilizing the existing assumptions, by Order179/01 the Board established a RSR range of $50 million to $80 million. Concurrently, MPI affirmed its then-RSR target range, $80 million to $100 million, not "materially" different from the range selected by the Board.

There matters stood until the 2004 rate hearing, at which a) MPI reported no material change to its risk profile warranting an update to the Risk Analysis, and b) the Board rejected the use of OSFI's MCT. In Order 148/04, the Board indicated that the Board's RSR's range, $50 million to $80 million, should be inflated to reflect increases in annual Gross Written Premium.

Though it developed the twin-analyses, Risk Analysis and VAR, intending the results to be the basis for the RSR target range, MPI now favours reliance on OSFI's MCT, an approach it initially rejected. At the 2005 hearing, MPI first proposed that MCT replace the Risk Analysis as the determining factor in establishing a RSR target range. At this year's hearing, MPI reaffirmed its preference for MCT to serve as the basis for determining the RSR range, as opposed to the

Risk Analysis. On MPI's direction, Mr. Christie prepared a DCAT for the 2006 hearing; the analysis supported MPI's renewed call for a higher MCT-based RSR target range.

MCT's methodology, which determines the ratio of capital available to capital required, provides a single index of financial strength. DCAT projects future operating results based on an insurer's business plan subjected to projections of a variety of plausible adverse events.

The projected effect of various adverse events, combined or individual, and whether non-recurring (major hailstorm) or continuing (heightened inflation without a quick rate-adjustment reaction by the regulator), is evaluated with respect to the risk of depleting an insurer's capital (RSR and retained earnings in MPI's case). At this hearing, Mr. Christie opined that the most adverse development, one that could deplete the RSR, would be a sustained 3% increase in the rate of annual inflation not responded to by timely premium increases.

DCAT seeks to identify adverse event scenarios individually, exploring the integration of two or more adverse scenarios only if one or more of the events are considered to be of comparable probability to the base scenario. Typically, the objective is to test adverse scenarios reflecting a consistent plausibility level of about a one in one hundred year event occurrence. Integration of two or more adverse scenarios is usually not performed, and it is impossible to be precise in defining adverse scenarios. As well, DCAT identifies and quantifies the relative effectiveness of alternate corrective actions.

MPI advised of its intention for MCT ratios to become an integral part of the schedules it provides each year in support of its annual rate application.

As previously indicated, until MPI decided to rely on MCT rather than the Risk Analysis, the difference between its recommended RSR range and that selected by the Board was relatively modest - $20 million in the case of the range maximum.

MPI opined that the use of MCT represents industry best practice, employed not only by private insurers but also by public insurance companies ICBC and SGI. MPI's proposed use of 50% to 100% as an acceptable MCT range is significantly lower than the 150% target required by OSFI of its regulated private insurers. SGI employs a range of 100% to 125% of MCT, while ICBC uses a minimum level of 100% of MCT. While ICBC and SGI manage Basic mandatory insurance programs as monopolies, similar in nature to MPI, there are differences in approach that may suggest differences in RSR requirements. ICBC's plan is tort based, and property damage is an optional coverage with an active competition in place. Tort has provided less stable cost trends than total no fault. SGI offers a tort option to no fault, though apparently few policyholders choose tort. The tort design is accompanied by significantly lower no fault accident benefits – those judged "at fault" rely only on no fault accident benefits with the potentially higher settlements for bodily injury claims of tort reserved for the party judged not to be at fault). SGI also markets optional general property and liability lines in other provinces, as well as Saskatchewan. MPI's sole market is Manitoba, and it is not in the general property and liability insurance business.

MPI's proposed adoption of a 50% to 100% MCT range was based on management judgement, supported by the expert opinion of Mr. Christie. That said, Professors Hum and Simpson advised against abandoning the Board's RSR target range and recommended continued reliance on the Risk Analysis and VAR (approaches supported in prior hearings by the Board, interveners, and, initially, MPI), opposing MPI's support of a range based on MCT.

<u>DVL and its Importance to Basic</u>

DVL was a provincial government operation until its late 2004 transfer to MPI. DVL administers and assesses fees for the registration of motor vehicles, regulates driver licenses, and manages the Driver Class Licensing Program.

Through this latter program, drivers are required to meet vision, physical ability, road safety knowledge, and skill standards for each class of vehicle. As well, DVL manages the merit-demerit point and accident surcharge models, integral to the present bonus/ malus system of "rewarding" and "punishing" good and bad driving habits, respectively.

Approximately three hundred provincial civil servants became MPI staff members with the DVL transfer. Along with the compensation, occupancy and other operating costs associated with a large workforce with substantial responsibilities came the necessity to upgrade an outdated computer system. In the absence of the transfer, the outdated computer system would have been the Province's responsibility. As it is, MPI is making the necessary upgrading investment, though, on the other hand, it now has the opportunity to modify the bonus malus program towards improving future driver behaviour.

Under the terms of the transfer agreement, MPI receives a flat annual payment of $21 million towards the now $29 million annual cost of DVL operations; there is no inflation factor. The payment is not to vary unless additional functionality is added to functions associated with the Province's revenue stream arising out of DVL operations. MPI plans to spend $21.7 million as part of its BPR to, among other things, efficaciously integrate DVL within its overall operations, primarily Basic.

MPI had a choice as to where to locate DVL operations. It chose to establish a new "line of business" within the unregulated Extension line of business, beyond the direct oversight of the Public Utilities Board and the annual rate setting process.

While MPI has located DVL within Extension, Extension operations, like SRE, are tightly tied to MPI's Basic line:

a) common Board of Directors, management, staff and agent complement; and
b) operations founded on and supported by the basic mandatory program infrastructure.

MPI's annual operating costs are allocated between Basic, Extension and SRE, though the formula supporting the allocation remains to be adjusted to take into account linkages between former DVL functions now performed from the Extension division platform and the Basic mandatory program.

Basic, Extension and SRE are supported by a co-mingled investment portfolio, with investment revenue also allocated by means of a formula. The retained earnings of both Extension and SRE, the former severely depressed by annual net losses on DVL operations, arise from a common policyholder base, shared with the Basic program. Until this hearing, the expectation established by MPI was that balances above a defined threshold of Extension and SRE retained earnings would be transferred annually to the Basic program's RSR.

Revenue from DVL operations with respect to driver license fees, the latter shared with MPI, flow to the Province. The financial aspects of the bonus/malus program, soon to migrate to the Driver Safety Rating program, fall to MPI. Improved driver behaviour that may arise out of the Drive Safety Rating program should lead to reduced accidents and claims, with the prospect of reduced claims incurred in future years (leaving aside inflation and volume increases).

In the absence of DVL functionality, the ability of MPI and the government to positively impact the frequency of accidents and injuries would be reduced, and MPI's monopoly mandatory basic insurance program would be left compensating the injured and fixing or replacing the "tin." MPI has more important work ahead, that of bringing down the human toll arising out of motor vehicle accidents.

As previously indicated, with the frequency of motor vehicle caused serious injuries and fatalities in Manitoba remaining unacceptably high; the key to reducing the frequency may lie with the new Driver Rating program and an improved approach to rewarding good driving habits and punishing poor ones.

With national and provincial safety-orientated partners, MPI has established targets for fatality and injury frequency for 2010, the targets represent substantial decreases from recent experience.

2010 National Target:
Number of Fatalities and Serious Injuries
Baseline Data and Targets

		1996-2001 Ave. Baseline Figure	2004	2002-2004 ave	2004	2002-2004 ave	2010 target
					Progress		
Killed	NF	42.2	37.0	38.7	-12.3	-8.3	29.5
	PE	19.5	30.0	22.3	53.8	14.4	13.7
	NS	91.7	90.0	82.7	-1.9	-9.8	64.2
	NB	98.2	71.0	89.3	-27.7	-9.1	68.7
	QC	758.2	647.0	657.0	-14.7	-13.3	530.7
	ON	874.0	799.0	834.3	-8.6	-4.5	611.8
	MB	108.5	99.0	104.0	-8.8	-4.1	76.0
	SK	158.2	126.0	137.3	-20.4	-13.2	110.7
	AB	387.0	387.0	381.3	0.0	-1.5	270.9
	BC	410.5	430.0	446.0	4.8	8.6	287.4
	YK	8.5	5.0	8.0	-41.2	-5.9	6.0
	NWT	8.8	4.0	6.3	-54.5	-28.4	6.2
Seriously Injured	NF	254.5	179.0	194.7	-29.7	-23.5	178.2
	PE	95.3	85.0	80.7	-10.8	-15.3	66.7
	NS	408.0	311.0	331.3	-2.8	-18.8	285.6
	NB	500.5	387.0	406.3	-22.7	-18.8	350.4
	QC	5571.2	6038.0	5852.7	8.4	5.1	3899.8
	ON	4509.3	3565.0	3922.7	-20.9	-13.0	3156.5
	MB	628.7	548.0	540.7	-12.8	-14.0	440.1
	SK	664.5	520.0	570.0	-21.7	-14.2	465.2
	AB	2936.7	3285.0	3299.7	11.9	12.4	2055.7
	BC	NA	NA	NA	NA	NA	NA
	YK	40.3	26.0	38.7	-35.5	-4.0	28.2
	NWT	29.7	25.0	28.3	-15.8	-4.7	20.8

Overall Effect of DVL on Basic and MPI

Notwithstanding the Board’s 2005 recommendation that MPI relocate DVL within Basic, the Corporation advised the 2006 hearing that DVL operations would continue to be housed within Extension, outside the Board’s regulatory jurisdiction.

DVL operations were again projected to negatively impact the results expected from both Extension and Basic operations. With recoveries from the Province projected at $21 million and costs of $29.5 million, MPI forecast a loss on DVL operations of $8.5 million in 2006/07. As reported in Order 150/05, the DVL transfer also continues to result in an annual loss of $6 million in provincial commission offset payments to MPI's Basic program. This is due to the Province's separate decision to cease making what were longstanding annual payments to Basic with respect to services performed by brokers and paid for by MPI's Basic division.

In aggregate, the Board understands the annual loss to MPI arising out of the DVL transfer now to be in the order of $14 million (the equivalent of approximately 2% on the average annual premium).

The $30 million budget for the BPR, includes the cost of integrating DVL operations within overall MPI operations. BPR costs have been deferred for amortization over the future periods expected to enjoy cost savings and revenue growth arising out of the project.

The BPR budget includes a projected $7.1 million expenditure to implement the Driver Safety Rating program (to be considered by the Board in a special hearing next spring).

Importance of Investment Income

Investment income is a major component of MPI's Basic income, and with annual underwriting losses now the norm, investment income is required and expected to provide for balanced budgets and results. As previously indicated, MPI's investment portfolio is not segregated by line of business but co-mingled; investment income is allocated between the Basic program and the competitive lines on the basis of a long-established formula.

MPI's investment portfolio now approximates $2 billion (75 % bonds; 24 % equities; .5 of 1% venture capital; and 1 % cash and short term investments), having consistently increased over the years since the introduction of PIPP. MPI maintains an Investment Committee (of its Board of Directors), an Investment Working Committee (including representatives from 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, which has statutorily-based authority over MPI's investments. With respect to the equity holdings, external investment managers engaged by the Department of Finance manage the portfolio segment.

The investment portfolio is increasing due to two major factors:

a) the continued growth in the PIPP component of Unpaid Claims; and
b) annual net income, resulting in increased retained earnings and RSR.

PIPP claims have a longer duration that found with the former tort-environment, this because PIPP claimants receive ongoing weekly indemnity and retirement benefit payments and have medical costs covered for as long as they are unable to return to work as a result of motor vehicle accidents. There may be a-lengthy relationship between claimants and MPI under PIPP, and this stands in contrast to the shorter periods of involvement associated with tort and pre-PIPP accident benefit claims. Under tort, weekly indemnity benefits were low, with the major benefit to claimants being eventual lump sum settlements. Thus the change from tort to no fault largely accounts for the growth in Unpaid Claims and, concurrently, the growth of the investment portfolio.

MPI’s policy requires a 105% ratio of market value to book value of the investment portfolio before MPI may sell securities <u>and</u> record the capital gain in its accounts. MPI reported the expectation of capital gains in each fiscal year, indicating unrealized gains held within the investment portfolio as of February 28, 2006 was approximately $55 million.

When the 105% ratio is exceeded, MPI advised it may direct its investment managers to sell securities to realize gains for recording in its accounts. Unlike Canada Revenue Agency’s approach to security sales, whereby securities sold cannot be bought back within a 30-day period without financial implications, MPI’s investment policy does not require MPI to refrain from repurchasing a security sold to realize a capital gain.

That said, MPI indicated that its investment managers act in the best interest of the portfolio, buying and selling in accordance with the Corporation's investment policy and its focus on the long term, not simply to enhance MPI's short-term net income.

Generally accepted accounting principles have been amended, and MPI indicated it would report its investment holdings from March 1, 2007 including unrealized gains on securities held for trading as well as interest and dividend receipts. Unrealized gains will be segregated within retained earnings under the heading "Cumulative Other Comprehensive Income." MPI suggested that the Board ignore "other comprehensive income" in setting MPI's rates, preferring that unrealized investment gains not be considered a component of annual net income.

MPI forecasts annual returns on its equity holdings at the same rate as it expects from government bonds, and does not give effect to what is known as the ERP, that being the "expected" premium over government bond rates anticipated for equity investments. MPI defended its conservative approach with respect to equity return expectations, stating that it cannot be assured in any one year that equities will deliver a return in excess of government bonds. Equities represent approximately 20% of MPI's investment portfolio, that is, $400 million.

Anti-theft Initiative

At the hearing, MPI reported extensively on its anti auto theft initiatives, which began in earnest in 2004:

a) Winnipeg Auto Theft Suppression Strategy (WATSS), initiated by the Provincial Auto Theft Task Force; a partnership between MPI, the WPS, the RCMP and Manitoba Justice (Justice) monitors young offenders convicted of auto theft for compliance with Court-imposed conditions; and
b) vehicle engine immobilizers, this being MPI's long term strategy towards preventing auto theft.

With respect to WATSS, MPI reported funding arrangements costing $1.5 million annually:

a) a longstanding arrangement with WPS -- support for the WPS auto theft unit at an annual cost to MPI of $550,000; and
b) a two year funding commitment to the provincial Department of Justice with respect to Crown prosecutors and probation officers, $896,000 per year, expiring in mid-2007.

MPI indicated that WATSS results were less effective than expected through to the fall of this year, due in large part to:
a) an unexpected summer 2006 rotation of WPS officers that removed experienced officers from the auto theft file during the peak theft months; and
b) the recent trend to new and older offenders becoming involved in auto theft, WATSS being focused largely on restricting the criminal activities of identified youth offenders.

MPI indicated that WPS staffing of the auto theft unit was restored and the combination of police and probation officers' focus on youth offenders was again providing results, reducing the number of auto thefts. WATSS is a bridging strategy, suppressing thefts while the installation of immobilizers continues.

With respect to immobilizers, MPI's approach has been modified to adjust for experience. At the outset, the immobilizer program generally involved the commitment of $140 by vehicle owners with MPI contributing a like amount. Now, for vehicles on MPI's "most-at-risk" list, the top 150 makes and models most stolen in Winnipeg, vehicle owners receive a free immobilizer; the same ongoing annual discounts are offered to all after-market immobilized vehicles. As well, the immobilizer program was recently extended to all most-at-risk vehicles throughout Manitoba.

All other vehicles remain eligible for a grant of $140, representing 50% of the immobilizer cost, with the remainder able to be financed interest free over up to five years. As previously indicated, all immobilized vehicles receive an annual $40 discount on their insurance premiums.

In addition, through a regulation of the government, as of September 1:
a) "most at risk" vehicles brought into Manitoba must be immobilized prior to registration; and
b) "most at risk" vehicles stolen must be immobilized before being returned to service.

MPI's goal is for 90% of “most-at-risk” Winnipeg vehicles to have engine immobilizers installed by the end of February 2008. If the goal is reached, approximately 72,000 “most at risk” vehicles in Winnipeg will have after-market immobilizers by then. As of September 27th, 2006, MPI reported 30,496 “most-at-risk” vehicles with immobilizers, a level MPI held indicative of progress towards the goal.

MPI advised that if immobilizer installations decline in the fall and winter of 2006/07, before the target is reached, it may approach the Board through its application for the 2008/09 insurance year for permission to levy a surcharge against “most-at-risk” vehicles not immobilized. The 2008/09 rate application is expected to be provided to the Board in late June 2007.

Presenters

At the annual MPI rate hearing, time is reserved for presentations from the public. Presenters are not restricted as to their topic of interest, though time constraints are placed on presentations and presenters are not sworn in. Cross examination of presenters is not performed and what is presented is not evidence before the Board, though the Board, MPI and the interveners take note of what is said.

Ms. Hyworren, a presenter at the hearing, brought to the attention of the Board a rate classification issue warranting attention, though the issue was not addressed by MPI or any of the interveners during the hearing.

Ms. Hyworren questioned the classification of the passenger vehicles of Winnipeg Free Press newspaper carriers, a classification which she noted had led to an annual rate of $325 as compared to $30 “a few years ago.” She noted that the carriers deliver their papers in a limited period of time during the very early morning when traffic is extremely light. She noted that a common characteristic of carriers is to park their vehicles along a street and deliver the newspapers to numerous residences by foot and hand before moving their vehicle.

The other presenters and the essence of their remarks were:

a) Mr. Hacault, representing the Manitoba Bar Association (MBA): opined that total no fault (MPI's PIPP-based Basic program) is not in the public interest because most claimants are without independent and effective advice.

b) Ms. Gibb: an independent consultant: claimed MPI has become more adversarial, resulting in claimant disadvantage with respect to being able to effectively substantiate PIPP claims. Ms. Gibb opined claimants lack financial resources to pursue denied or limited claims, citing no independent body involved in assessing claim merits until the appeal process. She suggested healthcare consultants are pressured to support MPI positions, and records have been altered on occasion.

c) Mr. Toker, a policyholder: suggested MPI's expenditures are not always cost-effective; average rates should be 10% to 20% lower, immobilizers should be mandatory and paid for by vehicle owners, disputed the fairness of the classification system, and suggested an exhaustive review should be undertaken as to MPI's expenditure practices.

d) Mr. Keiller, a policyholder: suggested that motorcycle insurance be removed from Basic mandatory coverage and placed in the competitive market (in response to high and consistently increasing rates).

e) Mr. Houghton, a policyholder and President of CMMG: reported on the contribution of motorcycles to the Manitoba economy, indicating that registered motorcycles and the sales of motorcycles in Manitoba are lower due to high insurance rates; noted the relatively low impact of motorcycles on the environment, in contrast to other vehicles; recommended that the Board-directed loss transfer approach be extended to collision and comprehensive coverage; cited the importance of driver education and training for motorcyclists; raised questions as to the effect and fairness of the current territory rating system – suggesting that some motorcycles were being registered improperly to avoid the higher premiums of territory 1; suggested changes in coverage offered to motorcycle owners – citing problems related to the availability of comprehensive coverage; and suggested the immobilizer program be extended to include GPS locators for motorcycles.

f) Mr. McNaught, a moped dealer, Vespa Winnipeg: raised questions concerning the fairness and efficacy of current moped/scooter vehicle definitions; suggested MPI was having difficulty in properly assessing damage to a moped or scooter, leading to write-offs and higher than necessary property damage claims and resultant premiums; spoke to increasing popularity of mopeds and suggested that fuel efficiency and low insurance and costs were a major factor in growing popularity; and expressed concern with MPI's proposed large increases for moped owners.

3.0 BOARD FINDINGS

Preamble

The Board appreciates the contributions made and cooperation extended by MPI and 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. While the Board's jurisdiction and process is limited to Basic program "rates and service", Presenters may bring perspectives on issues of interest not necessarily addressed by the other participants, providing useful background information to the Board and MPI. Information and opinions provided by presenters at the annual hearings may lead to topics being explored by MPI and/or in future Board proceedings.

MPI is important to Manitoba, not only for its insurance offerings and service but also with respect to its investments in Manitoba infrastructure and overall economic impact. MPI's investment pool is one of the largest in Manitoba, with approximately 20% of the $2 billion portfolio devoted to the bond debt of Manitoba's public sector (municipalities, hospitals, schools and the Province).

The Board's findings reflect the evidence provided through the application process, and provide the Board's determination of the public interest. The Board interprets the "public interest" to include not only financial issues of concern to policyholders, including the financial situation of MPI itself, but also the broader interests of society, inclusive of the objectives established by the legislature for the monopoly compulsory motor vehicle insurance.

Items of Interest

The following matters raised at the hearing were of particular interest.

(a) The methodology to be employed to determine the appropriate range for the RSR:

the Board again rejects MPI's proposed reliance on MCT, the test employed by OSFI to determine the capital adequacy of private sector vehicle insurers, and will continue to depend upon the Risk Analysis supplemented by the VAR;

(b) MPI's cessation of previously assured transfers of deemed excess retained earnings in Extension and SRE to the RSR:

the Board recommends to government that Extension and SRE be made subject to Board oversight, and suggests to MPI that either transfers of excess Extension and SRE retained earnings be recommenced, a rebate be made to Extension and SRE policyholders, or premiums be reduced for Extension and SRE policyholders; while the Board presently has no jurisdiction over Extension and SRE it cannot help but be mindful of the spirit of the overall objectives for MPI and the interests of Basic policyholders also holding Extension and SRE policies;

(c) placement and net costs of former DVL functions:

while the transfer clearly provides a welcome opportunity for MPI to improve customer service and enhance road safety, the net annual cost to MPI arising out of the transfer and related actions now approximates $14 million. The Board reiterates its 2004 and 2005 recommendation that former DVL operations be transferred to Basic operations, with the annual net costs associated with or related to DVL operations to be offset as soon as practical. Offsets may arise through a combination of new revenue arising from the Driver Safety Rating program, reduced claims from the beneficial impact of the planned Driver Safety Rating program on motorist behaviour and experience, and operating cost savings to arise over the long term from the BPR;

(d) the auto theft initiative:

surcharges on “top 150” vehicles may prove required in the case of owners refusing to install immobilizers, notwithstanding free installation and future annual discounts – the “cost” in higher premiums, injuries, fatalities and other factors arising out of auto thefts represents an unnecessary level of risk;

(e) rate implications arising out of the Board’s 2005 claim attribution model changes:

the actuarially-indicated average premium for motorcycles declined by 15%, and upon the allocation method being extended to the collision cover, a further decline is expected;

(f) plans to review PIPP and develop benchmarks as to causation, nature and duration of claim and other matters, to replace the bonus/malus system with the Driver Safety Rating program, and to integrate DVL functions:

the Board supports thorough reviews, the transfer of DVL functions to Basic operations, and the development of the Driver Safety Rating program to advance road safety;

(g) MPI’s investment asset mix and yields:

the Board has continuing concern with the go-forward investment yield prospects of the current fixed-income dominated asset mix, noting that each 1% of increased annual yield is the equivalent of a 2% Basic premium reduction;

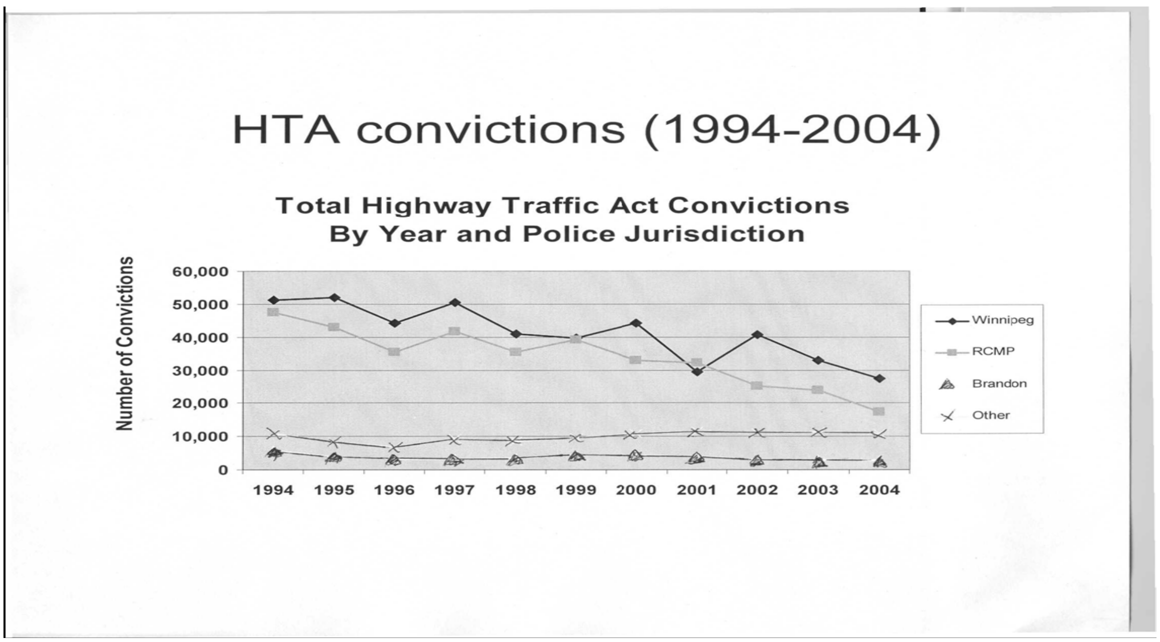
(h) Motorcycles:

the Board supports MPI’s separation of private-use owned mopeds from mopeds held in rental fleets, will restrain the annual rate of premium increase for mopeds to reduce rate shock, and recommends MPI and the government review the law as it pertains to mopeds and scooters; as well, the Board promotes discussion between CMMG, SM and MPI to address unresolved issues;

(i) inter-provincial trucking:

the ongoing subsidization of inter-provincial trucking could be offset by the transfer of SRE net income arising out of the inter-provincial trucking policyholder segment to Basic;

(j) traffic violation enforcement:



the Board suggests a link between the continuing high level of accidents and injuries and reduced traffic law enforcement, and recommends MPI enter into discussions with the Province, RCMP and WPS to seek an improved understanding as to the links and effects of reduced enforcement and, potentially, enforcement improvements;

(k) single-vehicle accidents:

the Board notes the fluctuations in the annual proportion of single-vehicle motorcycle accidents to overall motorcycle accidents and recommends that MPI further its research into the causal factors in conjunction with its partners in safety;

(l) level of claims handling and other operating costs:

mindful of the DVL integration transition and MPI's investment in process improvements, the Board compares MPI's operating cost experience with other public auto insurers and suggests that the need to constrain further operating cost increases be advanced through the BPR; and

(m) environmental matters:

the interplay between insurance and environmental principles is to be determined; the Board notes that MPI awaits government direction and directs further research.

SUMMARY OF FINDINGS

The Board finds:

a) MPI's application for Basic premiums and fees for 2007/08 acceptable, subject to amendments set out below;

b) the RSR to be in excess of current and projected requirements, as a result of which the second premium rebate in two years is directed;

c) a Risk Analysis supported by a VAR provides a statistically-based approach tailored for MPI's situation and circumstances that remains appropriate for use in supporting the Board's determination of an appropriate RSR range;

d) MCT to be a useful mechanism for monitoring risk trends (future amendments to the RSR range will take into account evidence from a number of sources, including, potentially, MCT, to be employed as a supplement to updated Risk Analysis and VAR, the latter updates required only as MPI or the Board deems advisable and based on evidence of need);

e) the RSR range requires being reset (the Board amends the range to $69 million to $105 million, and will continue to include the IIF in its determination of RSR);

f) the retained earnings of Extension and SRE will continue to be considered a component of overall MPI financial strength in the determination of rates;

g) concern over MPI's cessation of transfers of Extension and SRE retained earnings to RSR;

h) opportunity and concern as to the eventual effect of DVL operations on Basic;

i) the anti-theft initiative to be reflective of the public interest, with surcharges against vehicles without immobilizers to be considered if the initiative fails to secure a sufficiently high level of voluntary compliance;

j) benchmarks for PIPP are important, and are strongly supported by the Board as a means of better assuring *value for money*, cost-effectiveness and good customer service;

k) updating the bonus/malus system by the implementation of a Driver Safety Rating program, to be reviewed at a special Board hearing in the spring of 2007, is in the public interest, and could play a determining role in offsetting the net costs to MPI of the DVL transfer while enhancing long-term road safety;

l) MPI's review of DVL and Basic administrative functions should be followed through with as expeditiously as possible, with the twin objectives of improving customer service and reducing annual operating costs;

m) DVL operations belong within the Basic program, and the net cost of operating, modifying and integrating DVL operations likely should primarily rest with Basic – notwithstanding that the net cost would depress Basic net income forecasts, a new shared services cost allocation review should take place as soon as possible;

n) the appropriate way to analyse investment performance is on a market value basis, with market values deemed for non-liquid, not-traded Manitoba securities. The current approach of measuring investment yield based on a mix of interest and dividend receipts and gains realized or unrealized on equities is not fully representative of performance;

o) comprehensive income, a balance sheet category to arise with the adoption of new generally accepting accounting principles with respect to investment accounting, will be considered by the Board in evaluating the financial strength of MPI for rate setting purposes – today only securities that are traded are considered in determining net income, with the current recognition of unrealized gains only upon sale, sale being determined by MPI in part to support annual revenue forecasts, is inappropriate;

p) MPI's investment portfolio warrants further diversification to increase expected annual returns – market bond rates are low, prudent diversification to include increased equity participation should assist in improving annual investment returns;

q) The forecasting approach with respect to projecting investment income from equities should take into account a risk premium of 1.5% per annum;

r) a conflict of interest (perceived if not real) remains with the charge of investment management fees by the Province on the portion of MPI's portfolio invested in Province of Manitoba securities;

s) the ongoing subsidy to inter-provincial trucking being absorbed by other Basic policyholders should be offset by the annual transfers of equivalent SRE net income;

t) analyses of the annual costs to MPI of speeding, impaired driving, failure to use seatbelts, and other accident factors including collisions with wildlife, as well as understanding as to the reasons, effects and implications associated with the ten-year decline in traffic violations issued by the WPS and the RCMP, are required to inform MPI's approach to driver education and training and the to-be-developed Driver Safety Rating program;

u) a review of the experience with graduated licensing and red light cameras is required; and

v) benchmarking of commissions paid, claims and operating costs, and personnel levels, against the experience of private and other public insurers should be developed, to provide assurance that expenditures and complement levels represent best practices and *value for money*.

Financial Directions

The Board accepts MPI's proposals with respect to an overall 2.6% decrease in Basic premiums, fees and discounts for 2007/08, excepting for directing MPI to:

1. provide a premium rebate of 10% to all policyholders who paid Basic compulsory insurance premiums in the 2005/06 insurance year. Premiums paid for 2005/06 include all Basic compulsory premiums written during 2005/06, net of any premium refunds and after any fleet rebates (an estimated $60 million rebate is to be paid separate from the premium collection process); and
2. without affecting premiums for any other class or vehicle, amend proposed premium changes for 2007/08 to:
   - i) reduce the average increase in motorcycle rates to 5% rather than the proposed 8.4%; and
   - ii) cap increases in moped premium rates at 25% per annum, while retaining the 20% cap for increases for other vehicles (no cap is to apply for decreases to motor scooter premiums).

The Board anticipates that the amendments to motorcycles (all categories including mopeds) will, in aggregate, marginally increase the overall average percentage premium decline and decrease the net income forecast filed by MPI for 2007/08. However, with respect to the net income forecast, the Board notionally amends that forecast to include an ERP of 1.5%; this addition more than addresses the shortfall to arise out of the motorcycle rate amendments.

Keys to Future Premium Stability and/or Reductions

Overall, the Board holds that the route to improved MPI operating and financial performance for the benefit of its policyholders is through:

a) an improved understanding of claims development, particularly PIPP experience and the factors driving accident and injury frequency and severity;
b) a more effective Driver Safety Rating program than the existing bonus/malus system, in providing incentives for good driving and penalties for poor and unsafe driving practices;
c) success of the anti-theft initiative;

d) improvements to driver education and training;
e) the BPR;
f) benchmarking of non-claim expenses and personnel complement numbers against private and other public insurers;
g) further investment diversification, with a focus on improved market yields;
h) costing of proposed benefit additions and enhancements (going-forward and retroactive effects) and public disclosure of plans through the Board hearing process ahead of implementation;
i) consultation with policyholder and other interest groups between hearings;
j) identification and resolve of policyholder equity issues across existing boundaries between Basic and the competitive lines;
k) the Extension of the Board's oversight to Extension and SRE; and
l) a better understanding as to the potential linkages between environmental objectives and fairness of insurance rates.

RATIONALE FOR THE BOARD'S FINDINGS

Purpose of the RSR

Before this year's hearing, MPI long defined its RSR as being "intended to protect motorists from rate increases made necessary by unexpected events and losses arising from non-recurring events or factors." While MPI put forward a revised definition at this year's hearing, the Board understands the general concept is continued and understood by all parties to the hearing.

Towards protecting the RSR, assuming it is within its target range and expected to remain there during the then-current year, MPI's application to the Board for the upcoming fiscal and insurance year is to be based on revenues adequate to meet expected costs, and to avoid a loss. By a loss, the Board means a loss that would arise out of the normal course of business given the normal range of experience expected to arise with respect to claims development and investment experience.

The RSR's purpose is to provide a buffer against an unexpected large loss that may arise out of actuarial adjustments, major investment downturns expected to have a lengthy duration, widespread and serious hailstorms, or a bad run of serious injuries or fatalities. In short, the RSR is retained to meet the financial impact of events not expected to recur on a regular basis. Other than for the RSR, an unforeseen event could prompt a large surcharge and policyholder rate shock; an adequate RSR allows "time" to adjust, providing for the avoidance of rate shock.

As to what constitutes rate shock and whether rate shock should always be avoided, the Board is less sanguine. At one time in these annual proceedings, rate shock was considered to be a rate increase of 10% or more. If this is the definition, avoiding rate shock has not always been sought by MPI or realized in practice.

The RSR is to hold sufficient funds derived from the net income of past operations, and possibly, as expected to arise in the current year in progress, to allow general premium rate shock to be avoided in an upcoming insurance year. The RSR should be large enough to be able to withstand an unforeseen loss of a magnitude not anticipated to occur more than once in 40 years. In the event of a loss of such a magnitude depleting the RSR, possibly driving it into a deficit, the Board would examine with the Corporation and interveners the available options to rebuild the RSR, which would include premium surcharges over a period of years. While general rate shock is to be avoided where possible, the circumstances and requirements of the time would be taken into account.

General rate shock is represented by an average rate increase in one year in excess of 10%. While the balance of the RSR may allow for the avoidance of rate shock, it does not follow that rate shock need be avoided in all cases. In some circumstances, rate shock may be acceptable, perhaps as the preferred option to two difficult choices.

Notwithstanding alternative definitions suggested at this hearing, Board Order 151/00 confirmed and established 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. 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…"

Adequacy of RSR

Perhaps, the most significant matter debated at the recent hearing was the re-hearing of the issue of RSR adequacy. It is generally understood that a RSR is required and a range for the RSR is advisable, with rebates due to policyholders if exceeded and surcharges to be considered if under. However, differences of opinion continue as to what the range should be and how it should be established. The Board and interveners expressing an opinion on the topic preferred the Board's range as established arising out of last year's hearing - $65 million to $100 million, indexed for increases in future annual increases in gross written premiums. MPI favoured a higher range, $107 million to $214 million.

Major factors considered in addressing this issue include:

a) RSR balances, actual and forecast;
b) IIF balances, actual and forecasts;
c) six-month actual Basic net income, to August 31, 2006;
d) net income projections for 2006/07, 2007/08 and forward;
e) Extension and SRE net income, past (projection withheld by MPI);
f) net deficit on DVL operations, past and projected;
g) MPI's intentions as to Extension and SRE excess retained earnings transfers to RSR;
h) past fluctuations in annual Basic net income, causal factors and corrective actions;
i) past benefit program design amendments, retroactivity and rate impact;
j) plans, if any, for benefit or coverage amendments;
k) investment portfolio balances, yields, and asset mix;
l) unrealized gains or losses on investments, experience and forecast;

m) reinsurance in place and experience with respect to amendments;
n) Unpaid Claims, growth and variation in actual and projected;
o) Provision for Adverse Deviation (PfAD), experience and underlying assumptions;
p) PIPP experience, trends and forecasts;
q) budgeting approaches: *never* for a loss result;
r) views on RSR target range, methodology to determine, actual and forecast, adequacy;
s) origins, description, history and assumptions of the Risk Analysis, VAR analysis and MCT – with the assumption and expectation that future Risk Analysis and VAR analysis will be performed pursuant to the methodology and general assumptions used and previously approved by the Board;
t) understandings as to the purpose of the RSR and as to actions to occur when the RSR range is exceeded or its balance is below the minimum;
u) options, if the RSR is below the minimum of the accepted range; and
v) regulatory lag (the Board regulates only one insurer, MPI, and may accept an application to revise rates at any time between annual applications – regulatory lag in such circumstances is more associated with the time it may take MPI to determine a rate change is required than the Board to deal with it).

MPI's RSR balance as at the end of fiscal 2005/06 exceeded the Board's restated maximum of $105 million. And, the Board determined in Order 150/05 that the IIF is to be included as part of the RSR for testing its adequacy.

RSR *excess* is projected to increase in 2006/07, this view based on actual six month results to August 31, 2006 and the assumption that no material extraordinary loss will materialize before year-end sufficient to eliminate the six month surplus. That said, winter usually brings the risk of adverse experience. Considering MPI's longer-term forecasts, in the absence of a rate rebate or future rate decreases not currently forecast, the RSR will remain considerably in excess of the Board's revised maximum.

The destination for excess Extension and SRE retained earnings was brought into question by MPI. MPI previously indicated that excess Extension and SRE retained earnings would be transferred into the RSR. Prior to MPI's indication at this year's hearing that it would refrain from transferring excess Extension and SRE retained earnings into the RSR unless the Board accepted its recommended RSR range, the prospects for future Basic rate rebates given adequate future results were good.

The prospects for the future, excluding MPI's change of mind with respect to Extension and SRE earnings, including for future rate decreases, are good:

a) substantial annual savings from otherwise anticipated claims incurred levels should arise over time as a result of a progressively more effective immobilizer program which leads to reduced auto thefts and attendant costs;

b) correcting the current absence of an ERP in MPI's forecasts of investment income – MPI has not accounted for an ERP because of the lack of certainty that a premium will be realized over any forward twelve-month period; the Board takes a long-term view with respect to the prospects for investment income, noting that MPI and the Department of Finance invest in equities based on a reasonable assumption that prudently acquired equity investments will produce long-term yields higher than those obtainable from bonds, and that MPI and the Department of Finance assess investment manager performance over a longer timeframe than twelve months;

c) there are reasonable prospects that the new Driver Safety Rating program, to replace the existing bonus/malus approach, will prove more effective than the current bonus/malus approach in bringing down accident and injury levels over the long term, and, in the more immediate sense, in raising more revenue from net surcharges to be assessed with respect to poor driver behaviour and experience. In responding to a question from the Board at the recent hearing, MPI indicated it was reasonable to assume that the net financial result arising out of the Driver Safety Rating program – new revenue or lower claims incurred – would offset in part the losses now being incurred or related to DVL operations;

d) prospects with respect to the eventual results from MPI's PIPP program review, potentially improved cost control and/or rehabilitation of injured claimants would enhance MPI's long-term financial prospects; and

e) prospects to arise out of MPI's study of the casual factors of accidents, in that in full awareness of the annual costs of such matters as speeding, impaired driving, lack of driver and passenger restraints, single-vehicle collisions – including with wildlife, should assist in road safety program design.

In short, the Board notes the existence of ongoing situations (anti-theft, development of PIPP benchmarks, the 2010 targets for injury and fatality reductions, and the BPR) and planned projects (Driver Safety Rating) that should contribute to further improvements to the financial prospects of MPI.

And, MPI advised of no plans for future benefit or coverage changes of a material nature, let alone changes to be applied retroactively to a deleterious result. It is hoped and expected that any such proposals would be costed and discussed at a Board hearing before being adopted, with retroactivity avoided. Retroactivity may affect intergenerational equity as it involves costs for which no premiums have been collected, placing a burden on the RSR. Even if such an event materializes, the Board expects the means will be found to meet the challenge. To enhance the RSR ahead of *unknown* future amendments associated with higher costs and retroactive application is to assume MPI and government, present and future, would act before considering the implications for policyholder interests.

MPI began in 1971 without a RSR, fully dependent for financial assurance on its monopoly, as that of a mandatory insurance program, backed by the legislature and government that put it in place in support. Careful actions and monitoring over thirty-five years, with a major program amendment being implemented on the apprehension of a risk of future unacceptable rate increases (the implementation of PIPP), suggest that the RSR is only one mechanism by which unacceptably high premium increases have and can be avoided.

Yet, the Board recalls former US Secretary of Defence Donald Rumsfeld's observation: *We know what we know and we don't know what we don't know.* This simple observation may be worthy of consideration when reflecting on the question of what should be the size of MPI's RSR.

Professors Hum and Simpson, engaged by CAC/MSOS to provide expert *economic evidence*, suggested that the kind of unexpected event that *would* deplete MPI's RSR could be expected to occur once in forty years. They further suggested that the odds of such an adverse event happening two years in a row, an occurrence that would severely test the RSR, could be expected *once in sixteen hundred years*. Mr. Christie suggested that the RSR should be sufficient to meet the risk of being overwhelmed by an unforeseen non-recurring negative event that could be expected once *in a hundred years.*

The Board is of the view that accumulating an RSR to handle *anything* might be acceptable in a society where all of its members have no immediate personal fiscal concerns and are fine with having their service agencies hold their funds in reserve; this society is not in this situation.

Based on MPI's current investment policy, if Board-deemed excess RSR funds are not rebated to policyholders, they would be largely be invested in bonds, now with an average issue rate below 5%. It is not difficult to imagine that a great number of MPI's policyholders incur interest rates considerably higher than 5% on their debts, and would appreciate a return of excess MPI reserves for their personal use. It has not escaped the Board that funds restored to the economy benefit the economy.

The Board does not agree that the RSR should be so large as to make it a virtual impossibility that a premium surcharge representing a rate shock, even a general rate shock, would ever be required. Both the potential for rebates and premium surcharges play a role in providing the balance between the interests of MPI and its Basic program and the interests of its policyholders. As CAC/MSOS recommended at the hearing, the Board confirms the generally understood principle that goes back to Judge Kopstein's 1988 report: MPI is not to *knowingly* budget for a loss, particularly a material loss.

Rebate

Briefly put, the Board was not convinced by MPI's evidence and argument that the Board's target range for the RSR, as amended to reflect further growth of annual gross written premiums, is too low. Nor is the Board in agreement with MPI's view that an OSFI MCT-based approach to determining capital adequacy should be preferred over the "made-in-Manitoba" Risk Analysis/VAR approach.

Arriving at this position in light of the possible consequences for policyholders was not easy for the Board. The Board's angst over the matter is primarily due to MPI's indication that it will not honour its assurance of only a year ago to continue the annual transfer to Basic RSR of deemed excess retained earnings of the two competitive lines of business, Extension and SRE. That is, unless the Board accepts a MCT-based higher RSR target range, MPI will cease making the transfers.

Notwithstanding the "risk", the Board rejects MPI's insistence for a higher RSR target range, and will continue to count on MPI "doing the right thing" for motorist policyholders, for whose benefit the Corporation was created and operates.

As to the amount of rebate, the Board will restrict it to 10%, notwithstanding a 10% rebate will not reduce the pro forma aggregate of RSR and IIF to the Board's revised RSR range maximum. The claims experience of 2006/07 is not complete, and variations in investment experience are to be expected.

Rebate Distribution Methodology

As to the method of distribution for the rebate directed by the Board, and having considered the administrative costs involved, the Board rejects MPI's suggestion that rebates be provided through the subsequent year's premium billings rather than being paid separately, as was the case last year. If it were to be paid by discounting 2007/08 rates, the rebate would benefit the policyholders of 2007/08, not those of 2005/06.

Also, if MPI were to decide to rebate excess Extension and SRE retained earnings, hopefully after addressing Basic's shortfall arising out of the inter-provincial trucking subsidy, the Board anticipates MPI would pay the rebate in such a way as to benefit those who funded the excess.

Ever-present Risk of Premium Increase

While directing MPI to issue the second policyholder rebate in as many years, and the third in five years, the Board cannot assure policyholders that there will never be a time when Basic rates will have to be increased or surcharged. Unforeseen situations do develop, and even foreseen situations can develop losses such that the RSR would have to be rebuilt through surcharges. This has happened in the past and, more than likely, it will happen again at some point in the future.

By this direction the Board answers the question, should Basic policyholder funds deemed by the Board to be in excess of current need be held within the Corporation or returned to the policyholders? MPI agrees with the view that if the RSR is above its target range and forward premium rates are adequate, then a rebate should occur. This is also the view of the intervener community, and this Board.

Options and Risks to a Rebate

The prospect of leaving excess funds with MPI raised a concern expressed by some interveners. The suggestion was that excess funds may make it easier to consider new benefits, further personnel complement expansion, and/or contributions to unrelated activities. From such a perspective, leaving MPI with excess funds could lead to choices not possible in different circumstances.

A stronger argument for not leaving excess funds with MPI is that the potential for rebates has been the understanding at the annual hearings for years: when interveners accepted the need for surcharges, resisted budgeting for a loss, and advocated for a strong financial position for MPI.

Difficult as it is, in fairness it may be useful to consider the past record:

a) In 1987, the implementation of the Bonus/Malus program and sharply increased deductibles, brought about by government and MPI outside of the hearing process, with significant implications for policyholders that continue to this day (the Bonus/Malus concept is accepted by the Board and interveners as contributor to road safety and improved driver behaviour, it is finally to be amended by replacement by the Driver Safety Rating plan);

b) In 1994, by legislation supported by all parties, Manitoba adopted "total no fault" and abandoned reliance on tort – a major change with continuing implications that was not tested through the Board's hearing process that involves interveners;

c) In 2001, MPI proposed that excess retained earnings be donated to Manitoba universities (this proposal was opposed by the Board, and MPI reversed its position and the first rebate to policyholders resulted);

d) In 2005, DVL operations were transferred to MPI, this has led to an overall annual cost to MPI aggregating $14 million per year (though there are welcome opportunities that have also resulted from the transfer);

e) In the mid-1990s, government reclaimed in excess of $50 million previously contributed to MPI to offset dated reinsurance assumed losses;

f) In the late-1990s, a major new benefit was added, the Retirement Income Benefit with its retroactive impact on the RSR; and

g) In this year's hearing, MPI withdrew its previous commitment to transfer excess Extension and SRE retained earnings to the RSR.

In addition to the above major events that occurred outside of the annual hearing process, there has also been the implementation of an independent claims appeal process and, now, advisory service, the arrangements with WPS and Justice, and the immobilizer program, all major amendments with implications for policyholders.

While the Board chooses to take an optimistic view of likely future events, it is mindful of the perceptions and concerns of interveners and respects that such concerns are reasonable given the past record of experiences.

Prospects for the Future

Thus, the only question is whether the RSR is above the target range; to that question this Board says yes. To be justified in leaving excess funds with MPI, the Board is of the view that it would have to be aware of other situations suggesting caution. There was no such evidence at the hearing of:.

a) developing major losses in a subsequent financial period (based on MPI's six-month unaudited statements filed at the hearing, this is not the case);
b) an indication that MPI's Unpaid Claims liability (which includes IBNR and PfAD provisions) is understated (based on testimony by MPI's external actuary at the hearing and MPI's filed annual audited financial statements, this is not the case);
c) plans or indications of the likelihood of retroactive changes to benefit or coverage design that would require a material allocation of existing RSR to avoid policyholder rate shock (based on MPI's testimony at the hearing, this is not the case);
d) indications of unstable claims incurred development (again, not the case);
e) indications of re-insurer distress, suggesting MPI's re-insurers will not be able to meet calls arising out of adverse claims experience (no evidence proffered);
f) evidence of a speculative approach to investing (again, not the case); and/or
g) statistical evidence suggesting a probability of distress to arise out of foreseen events within the forecast horizon, such that the RSR would likely be depleted and rate shock would be required (again, not the case).

In fact, the Board notes the existence of "off balance sheet" prospects that suggest that future rates may not have to be as high as they are now, these including:

a) the anti-theft initiative, with a present value that may exceed $500 million;

b) prospects for an improved bonus/malus system, the to-be-developed Driver Safety Rating program (at the hearing, MPI indicated that the new program to incent good driving behaviour may result in reduced future claims incurred and increased MPI revenue, such that it will offset in full or in part the costs MPI now incurs with respect to its absorption of former DVL operations and the cancellation of the previously paid commission offset);
c) on-going efforts by MPI to improve its road safety initiatives (education and training) and introduce the Driver Safety Rating program, towards the goal of reducing the incidence and severity of accidents and injuries -- success could lead to significant reductions in inflation-adjusted claims incurred;
d) MPI's forecasting of future investment income without including a factor for the well-established ERP; this approach results in forecasts of annual net income that are understated by the ERP for equity investment holdings, annually;
e) MPI's initiative to understand the causal factors of PIPP development better, through the development of benchmarks to be compared against MPI and other insurer experience; knowledge brings the capacity to act, and improved action to rehabilitate the injured would bring prospects of reductions in claims incurred; and
f) Retained earnings of the Extension and SRE divisions, and unrealized gains held within the investment portfolio.

In short, the Board considers MPI's current financial situation and prospects as being very good. While a situation may well develop in the future causing a depletion of RSR, the Board is confident from the experience of the last thirty-five years of MPI operations and ongoing support from the Board, policyholders, interveners and government, that MPI's Basic program will meet future tests.

Board Order 179/01 states:

> "*Any future decisions of the Board that impact the level of RSR will be made taking into account the overall financial wellness of (MPI).*"

As the Board's position remains the same, even the full depletion of RSR would not necessarily mean MPI would lack resources and have to rely on large immediate surcharges against Basic policyholders. More than likely, there would be time to phase in increases, if not to find other means to address the situation.

Considering MPI's 35-year operating history, there has been only one year of a very large loss, that being 1986 and the result of the confluence of three factors: budgeting for a loss, poor claims experience and actuarial amendments. There have been a few instances since where MPI has proposed to budget at a loss, all rejected by the Board. There have been a few years of RSR surcharges, the surcharges being modest in level compared to the price shocks incurred by consumers for such goods as oil and gas. There have also been instances when changes were made to impact beneficially MPI's financial position and consumer rates: the adoption of PIPP was entirely ascribed to an effort to control costs and rates. The abandonment of general insurance lines including reinsurance assumed in the late 1980s was done for the stated purposes of avoiding future losses and strengthening MPI's position.

The Board notes the Insurance Corporation of British Columbia's (ICBC) 2005 action when it transferred over $500 million from its competitive lines of business to bolster the RSR of its Basic program, avoiding the otherwise large Basic premium increase that would have been required.

Rates

MPI's rate setting methodology is well established and thoroughly tested at these annual rate hearings. The approach continues to be actuarially sound and statistically driven. That said, ensuring fair rates across all major classes and rate groups is difficult given the reduced credibility associated with low vehicle "populations" in certain categories. The design of the system, which is subject to review at the annual hearings and amendment, a review that includes that of the Board's actuarial advisor, provides sufficient support to allow adequate confidence.

As well, the Board-approved overall cap of 20%, to be adjusted herein for 2007/08 premiums to 25% with respect to mopeds, and to allow the full indicated decrease for motor scooters proposed by MPI, provides continued assurance of reasonable attention to the risks of rate shock. If a future situation suggests that the Board should revisit its cap, the Board will do so after receiving the evidence and views of MPI and interveners.

In this hearing, MPI proposed increases exceeding 90% for mopeds. While the Board considers the avoidance of rate shock to be a worthy preoccupation, it does not think rate shock should be avoided *in all circumstances*. Rate shock may come from a combination of a required increase to meet anticipated business conditions and a necessary surcharge to rebuild a depleted RSR. Judgement is required, and the Board will continue to rely on MPI and interveners to these hearings to assist in making those judgements.

Jurisdiction

The Board understands that approximately 90% of mandatory Basic policyholders purchase Extension insurance from MPI, and that the vast majority of SRE policyholders are also found in the ranks of the mandatory Basic program. As Professors Hum and Simpson asserted at the hearing, MPI has a near or virtual monopoly in its Extension business, perhaps in the case of SRE as well.

MPI possesses major and dominating advantages in the provincial motor vehicle insurance field – common administrative and claim processing platform, agency network, mandatory monopoly Basic product, economies of scale, no income taxes, ease of customer transactions – all enabled by its monopoly of mandatory Basic coverage.

The Board, though driven by its mandate to seek and determine the public interest, is unable to oblige responses to its questions with respect to the Extension and SRE lines of business. Nor can the Board assure policyholders of overall equitable treatment with Extension and SRE policies, along with DVL operations, behind a wall it cannot breach. Accordingly, given the seemingly stark choice presented to it by MPI, the Board will have to count on MPI also being driven by the interests of its policyholders, while asking the government to change the marching orders.

The Board joins CAA in recommending to government that the Board's jurisdiction with respect to MPI be expanded to include the Extension and SRE lines of business. The decision to exclude the competitive lines from the Board's oversight was taken years ago, under very different circumstances. At the time, MPI was in the general insurance business as well as the reinsurance assumed field. The degree of its dominance over Extension and SRE competition was not known, nor was the policy issuance technology now in place with the broker network present.

If there are some aspects of the competitive lines that would best not be disclosed through the openness and transparency represented in the Board's hearing processes, ways and means can be found to deal with such, likely limited, situations. The reality is that MPI dominates the motor vehicle insurance field in Manitoba. While the Board was provided oversight to provide assurance to the policyholders, that oversight has reduced value when the same policyholders are also found in lines of business that the Board cannot survey.

For now, the Board will content itself with its understanding of MPI's options if it follows through with its stated intent of ending transfers of Extension and SRE retained earnings to Basic RSR. The Board understands MPI options to be:

a) rebate excess retained earnings to Extension and SRE policyholders;
b) reduce premiums; and/or
c) retain the excess (until either the Board is granted jurisdiction and provides direction or a need arises requiring a resumption of transfers to the Basic RSR).

The linkages between Extension, SRE and Basic are tight and neither of the competitive lines would be successful without the mandatory Basic program as the foundation. Action on one element of MPI's programming has clear implications for the other elements. If, for example, deductibles were raised for the Basic program, claims incurred would fall for Basic and net income rise, while at the same time there would be opportunities for Extension to earn more profit.

The situation is ripe for arbitrage and only the extension of the Board's jurisdiction to include general oversight of Extension and SRE can correct it.

DVL Transactions

The Board reiterates concerns expressed following the last two rate hearings 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, in MPI's worst case scenario, Basic can expect to receive $30 million less in commission offset payments over five years and Extension will experience $40 million less in net income over five years than would have been the case in the absence of the transfer of DVL functions. Furthermore, MPI will incur expenditures to overhaul DVL and related Basic functions.

Preceding the transfer of DVL, and as indicated by MPI, the Province unilaterally cancelled a longstanding annual $6 million commission offset payment by the Province effective the last quarter of 2003/04. As well, at the 2004 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 is contradicted by reality.

Only a successful integration of DVL into Basic operations reducing the net costs of DVL operations, and an enhanced bonus/malus system in the form of the Driver Safety Rating program, leading to reductions in injury frequency, will make the assumption of DVL cost effective in the long term.

The stated objectives for the transfer include customer service improvements, cost savings, increased efficiency and the reduction of Basic/ DVL overlap and duplication. The Board continues to have 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.

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 perhaps being a 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.

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

On the major concern of MPI, interveners and the Board, accidents and bodily injury, evidence at this year's hearing was consistent with that of recent previous years. The Board heard that the incidence of vehicle accident injuries in Manitoba remains among the highest in Canada.

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.

At the hearing, MPI suggested 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 did not disclose to the Board the terms of reference for its upcoming review of DVL, while indicating 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 reduce 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 availability of Retained Earnings of Extension for transfer to Basic's RSR. 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.

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 the last two years, that MPI place DVL within the purview of the Board and relocate DVL within Basic. The Board will not consider its jurisdiction to extend to reviewing or setting registration fees, which would remain the prerogative of the Province if the change were made.

Addressing Deficits – DVL and Inter-provincial Trucking

Currently, Basic's net income is somewhat exaggerated, in that net losses related to former DVL operations are absorbed by the Extension division, which is far from the main beneficiary or reason for DVL operations. If DVL were moved to Basic, and Basic's share of DVL net costs was to be 85%, then Basic's net income would fall. Several mechanisms are available to meet the impact of DVL.

a) BPR and its efforts to improve cost-effectiveness as well as service improvements;
b) the advent of the Driver Safety Rating program;
c) the inclusion of an ERP in forecasting investment income;
d) a move to market pricing for equity portfolio gains;
e) the transfer of SRE net income to offset Basic's losses on inter-provincial trucking; and
f) the possible resumption of transfers of excess retained earnings from Extension and SRE to the RSR.

Basic "loses" money every year through the subsidy to inter-provincial trucking (PIPP claims for inter-provincial truckers are covered by Basic with no attendant premiums collected), while SRE produces net income from the same base of policyholders, income that is not shared with Basic.

MCT use Going-forward

The Board accepts the regular development of MCT capital requirements *as a means to* monitor risk trends, and the Board is willing to consider the trend line of a series of MCT in its annual evaluation of the adequacy of the RSR.

That said, the Board will continue to rely on the Risk Analysis and VAR, if and when contemplating a major change in the risk profile of MPI with respect to consideration of the Board's RSR range. Many assumptions underlie the DCAT base and adverse scenarios; considerable judgement is required. The Board is not troubled by a requirement for management judgement.

Based on the most recent DCAT developed by Mr. Christie, MPI's financial condition (and hence its RSR) is not satisfactory in his opinion, with the RSR being well below the maximum of a 100% MCT requirement.

The Board has once again evaluated MPI's proposed employment of the MCT, which would be employed in two stages:

a) firstly, the Board assessed the merits of the MCT as a measure of the adequacy of RSR without comparing it, as a process, to the Risk Analysis/VAR approach; then

b) considered 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 basically to the upper limit of the Board's range for an acceptable RSR.)

Again, the Board concludes that while MCT is a reasonable test of an insurer's financial strength, and may prove a useful trend indicator over time, it is not superior to the Risk Analysis as employed for MPI.

MPI advised that OSFI requires regulated property and casualty companies to have MCT-calculated capital sufficient for a 150% MCT ratio, and reported that overall private insurers currently have 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. And, with respect to the role of OSFI as compared to the role of this Board, OSFI has no rate setting authority.

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. But, 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.

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.

The Board amended its RSR range in last year's Order, and established a means of indexing the range without requiring a new Risk Analysis and VAR. Applying that indexation factor, the Board now amends its range for the RSR again, and establishes a $69 million to $105 million range.

MPI may continue with MCT measurements and return to the Board at future annual rate hearings with evidence as to development. However, if it wishes to again challenge the Board's RSR range, the Board will not entertain a change without an updated Risk Analysis and VAR, and without considering the overall financial strength of MPI inclusive of the IIF and the retained earnings of the competitive lines. As stated in last year's Order, barring surprising developments, the Board expects to maintain this range, indexed for increases in Gross Written Premiums.

Amendments: Risk Analysis/VAR

While proposing the substitution of the MCT for the Risk Analysis and VAR, MPI complied with the Board's direction to file an updated Risk Analysis and VAR to compare with the results arising out of the MCT. In doing so, and as previously indicated, MPI recommended changes to three key elements of the approach, each of these resulting in changes supporting an increase in the RSR target range, these being:

a) updating claims incurred to reflect current price levels;
b) updating the terms and limits of its reinsurance arrangements; and

c) amending the investment performance outlook to a twelve-month horizon from the previous two and half-year perspective.

The Board accepts MPI's updating of the terms and limits of its reinsurance agreements, though cautions that the effect on the Risk Analysis should be taken into account when considering such changes. As to updating claims incurred to reflect current price levels, the Board accepts Professor Hum and Simpson's advice to reject this change; there are too many variables affecting claims incurred to support such a change. And, with respect to amending the investment performance outlook to a twelve-month horizon, the Board rejects this change as well; investment performance of conservatively-designed portfolios are best viewed over the longer rather than a shorter time horizon. Future Risk Analyses and VAR analyses are to reflect the Board's previously approved methodology, except for an update reflecting current reinsurance retentions.

Inclusion of the IIF

With respect to the IIF, the Board accepted MPI's 2004/05 reformulation of Basic Retained Earnings to provide for the segregation of the funds within the RSR. The Board finds 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 continued projection of long-term benefits expected to arise out of the initiative, the Board, as previously indicated, still considers the IIF a component of RSR for purposes of assessing RSR adequacy.

Furthermore, the Board considers MPI's accounting approach to IIF expenditures to be conservative. While, presently, the Board will not maintain a regulatory accounting of MPI's balance sheet position that is different from MPI's, a case could be made for deferring at least a portion of costs of the anti-theft initiative. Deferring costs for later amortization in periods when a program is expected to depress costs or enhance revenues has been held to be acceptable accounting in other fields.

Consider the approach taken by Manitoba Hydro to its demand side management expenditures (DSM); the utility defers these energy efficiency actions designed to reduce consumer energy consumption for amortization over a fifteen-year period. The amortization period assumes that these expenses will free up electricity generation for sale in the export market.

Provision for Adverse Deviation

While, MPI's forecasts and financial outlooks do not address unforeseen adverse events, MPI projects no need for annual revenue increases beyond those provided through the normal upgrade and volume factors through to and including 2011/12. One of the main supports for this outlook is the Provision for Adverse Deviation (PfAD) that forms an important component of MPI's Unpaid Claims liability.

PfAD serves as a buttress against the risk of adverse claims development with respect to "foreseen" events, known or expected claims. The Board observes that the PfAD continues to increase along with the increasing experience of PIPP; the PfAD balance has more than doubled over the past five years.

Also, with respect to the discount rate used in the calculation of Unpaid Claims, the Board observes that while the actuary's selection falls within the range of accepted actuarial practices, the rate is not at the highest acceptable level. If set at a higher level, a reduced Provision for Unpaid Claims and a higher RSR may result. The Board is not inferring that the Unpaid Claims liability is excessive, but indicates that MPI has the protection of a conservatively established PfAD.

Forecasting Accuracy

Similarly, the Board notes the recent pattern of overall Net Income variances from forecasts, and finds the Corporation to be, understandably, rather conservative in its estimating. Two examples of this *conservatism* are found with MPI's non-accounting for an ERP in investment income forecasting and its treatment of IIF expenditures, which are not deferred to be amortized in periods when savings from the auto theft initiative are expected to occur.

The provision for pre-PIPP bodily injury liability claims has, in recent years, been 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. For 2005/06, case reserves were reduced without reducing Claims Incurred, as general provisions were increased offsetting the case reserve declines.

The ongoing risk that a forecast may be too optimistic was previously largely offset by MPI's commitment to transfer excess SRE and Extension retained earnings to the RSR. The Board notes that MPI has indicated a change to this policy and will no longer make the transfers unless the Board accepts a MCT-based RSR range. Nonetheless, the Board will continue to include Extension and SRE, along with the undeniable value of a monopoly for Basic and a near monopoly for Extension, in its consideration of MPI's financial strength.

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, and while Extension Net Income forecasts cannot be ascribed the confidence once provided, the estimates available to the Board suggest that, despite DVL losses, Extension will continue to produce annual net income.

While Extension is subject to competition, MPI's domination of the market and its shared administrative platform with Basic provide MPI a near monopoly situation.

<u>Anti-Theft Initiative</u>

MPI's auto theft initiative is in the public interest.

Until 2005, MPI had reported steady annual increases in thefts, associated costs and related injuries involved, particularly in Winnipeg. MPI then-advised that the number of thefts was increasing by the month: " *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"*.

Despite the efforts of the police, government and MPI, the annual costs to policyholders associated with vehicle theft exceeded $35 million. Then, MPI took action towards 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. MPI correctly noted that the costs of auto theft go 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 the most effective end solution would be one involving prevention, and looked to electronic immobilizers. While increasing numbers of new 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 registered vehicles are not equipped with them. MPI began with an offer of a $40 annual premium reduction for vehicles with after-market immobilizers (the discount is "built-in" for vehicles with factory installed units), but the take-up was low and insufficient to bring about a reduction in thefts.

Determined to bring down auto theft, 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 provided motorists with the opportunity to equip their vehicles with immobilizers at no cost to themselves.

Since this initial offer also did not bring about the desired number of installations, MPI enhanced the approach by making free immobilizer installations available to owners of "most at risk" vehicles, and then extending that offer beyond Winnipeg to include all of Manitoba. As well, the government has further assisted by enacting regulations making it mandatory for older cars brought into the Province and cars recovered following a theft to have immobilizers installed prior to registration or returning to the road. The Board applauds all these measures.

MPI's target is for 90% of "top 150, most at risk" vehicles to be equipped with immobilizers. MPI's theft initiative also involves a suppression pilot project with the Department of Justice, its Corrections branch and the WPS. Through vigorous enforcement of parole requirements, it is hoped that the worst young offenders can be more effectively managed and future theft experience reduced. The costs of the suppression project are recorded as expenses in the year incurred.

In fiscal 2004/05, MPI revised its Basic Retained Earnings format to make its investment in the immobilizer program fully transparent. It allocated $40 million of Basic Retained Earnings to the IIF, and have since added a further $10 million.

As expenditures are incurred, the IIF is charged with the costs. MPI's initial business case forecast that the anti-theft initiative would realize over $80 million in claim cost reductions over the term of the initiative, this as compared to the-then $40 million of anticipated costs set aside in the IIF. At this year's hearing, the forecast of eventual savings was even more impressive, with annual savings of in excess of $30 million a year expected from 2013.

The success of MPI's anti-theft initiative is dependent on achieving MPI's target participation rate in Winnipeg. Owners not taking up the offer will own vehicles with a higher risk of being stolen. The Board finds the risks associated with auto theft very high, including financial, injury and social elements. Further, the Board encourages MPI to bring forward an application for premium surcharges against non-participating vehicle owners among the "top 150, most at risk" list if it determines that the present voluntary program will not meet its target.

The Board notes evidentiary support for taking stronger measures if the voluntary program is not effective. MPI presented evidence at both the 2005 and 2006 hearings that the "top 150" vehicles susceptible to theft are generating claims costs in excess of premium revenue, their premiums are substantially subsidized by other vehicles.

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 in the spring of 2005. Arising out the hearing was Board directed changes to MPI's claims attribution model.

The changes have resulted in a claims attribution approach sharing the costs of claims between the vehicle classification and groups involved in an accident. Single-vehicle claims attribution remains 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 are that the actuarially indicated rate for the motorcycle class has declined by 15% while the indicated rate for commercial class vehicles has increased. The new attribution approach has been implemented for PIPP costs, but has yet to have been extended to collision claims where further indicated rate reductions for motorcycles are likely to arise.

Given that the extension to collision has yet to occur, but would benefit motorcycles, the Board will direct MPI to limit the average increase in motorcycle premiums for 2007/08 to 5%.

Planned Corporate Reviews

MPI plans to review the operations and design of PIPP, implement a Driver Safety Rating program to replace the bonus/malus system, and continue with the BPR and the integration of DVL and related Basic administrative functions. The Board encourages and supports this work, towards achievement of:

a) customer service improvements;

b) eventual reductions in accident severity and frequency; and

c) reduced operating costs, or, at minimum, restraining future non-claim costs to increases linked to volume and inflation.

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," filed at the 2005 hearing. The independent actuary considered whether PIPP experience since its 1994 inception was consistent with the 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, benchmarks and analyses to guide PIPP management are 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 the end of the bonus/malus system with the advent of a new Driver Safety Rating program. The Board looks forward to a spring 2007 hearing on the new approach.

Investment Portfolio

Investment income is a primary contributor to suppressing premium levels. Underwriting losses are being incurred, so investment income is very important to policyholders. MPI has no expectation that it will break-even in the future on its overall insurance operations without the investment income from its portfolio. In future, MPI expects annual underwriting losses to continue to 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. When market interest rates were high, there was a stronger argument for fixed income dominated investment portfolio. This is no longer the case. Ten year Canadian government bonds now offer a market rate of approximately 4.00%.

Currently, MPI's perspective of its realized returns on investments is affected by its practice of not recognizing the increased market value of non-traded bonds as a result of interest rate decline. As a result, MPI mixes market returns on traded securities with coupon rates on non-traded securities, providing a less than adequate view of actual current situations.

If MPI were to value its entire portfolio on a deemed market value basis, recognizing increased values of bonds due to interest rate declines, and measured future year returns on the same basis, the Board expects the outlook for future investment returns would be significantly and negatively affected..

Equities comprise approximately 20% of the portfolio, and the portfolio 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.

Accordingly, the Board remains concerned with the prospects for future investment yield in low interest rate environment, and thus suggests a more diversified investment asset mix. The Board notes that at the 2004 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 into 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.

MPI’s portfolio is large enough to allow for it to be invested more in equities and to be diversified 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.

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 Department of Finance levies relatively modest annual fees of 0.075% and 0.03% of the fixed income and equity portfolios, respectively.

While the levy is modest, it is made on all securities including the fixed income securities purchased from the Province. 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. The Board understands that the Province has engaged an outside consultant to evaluate the situation.

Claims Handling and Other Operating Expenses

Excluding claims incurred, the costs associated with Basic, 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.

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 SM 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 CMMG to improve the perception, if not the reality, of fairness of approach to mopeds.

As to moped rates, the Board rejects MPI's proposal to increase the rates by in excess of 90%, and will approve increases of up to 25%. While slightly in excess of the normal cap of 20%, with the low average dollar premiums involved, the Board is satisfied with a 25% increase for mopeds. This will allow the actual moped rates to move towards the indicated rate over four years, while experience is unfolding concerning the segregation of rental mopeds.

As to the Board's acceptance of large decreases in motor scooter rates, the Board notes that there are less than 100 motor scooters and that relative to mopeds, and there are clearly classification issues to be resolved between mopeds and scooters, premiums have been too high for too long.

Newspaper Carrier Vehicles

Ms. Hyworren's concerns with respect to the common carrier charge imposed on the vehicles of Winnipeg Free Press carriers was not tested during the hearing, yet her issue strikes a chord with the Board as it may concern policyholder equity.

The Board suggests that MPI review Ms. Hyworren's comments and concerns and indicate proposed changes, if any, in next year's General Rate Application.

Inter-Provincial Trucking

MPI reports it has been incurring PIPP costs averaging $1.8 million per year with respect to inter-provincial truckers injured in accidents and filing 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, the risk of even greater costs and subsidy is present. MPI confirmed that the current approach subsidizes trucking firms at the cost of other vehicle owners, and has indicated the subsidy will continue.

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.

The new understanding arising out of the recent hearing is that SRE profits related to inter-provincial trucking may exceed the subsidy arising out of the Basic program; accordingly, the Board recommends that SRE transfer sufficient net income to Basic to cover the annual subsidy.

Road Safety

The prospects for future premium reductions would rise if the incidence and severity of injuries were reduced. Road safety measures are thus the 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.

The Board again expresses concern with reduced traffic infraction enforcement in Manitoba. MPI is urged to consult with the RCMP, the WPS and the Province to address what appears to be diminished enforcement in the context of persistently high accident and injury claims. The incidence and severity of 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 has developed an estimate of the annual claims costs associated with impaired driving, but has yet to develop similar estimates for speeding and lack of use of restraints. 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. MPI should move ahead with such analyses, as they are likely to prove useful in future amendments to its road safety program, and perhaps as well with the initial design of the Driver Safety Rating program.

The Board is pleased with MPI's report that graduated licensing has reduced the incidence and severity of claims of first-time drivers, and agrees with CAC/MSOS that a report outlining the experience to-date and prospects for the future should be filed with the Board at next year's GRA.

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. This said, the Board acknowledges MPI's need to prioritize its reviews.

<u>Environmental Matters</u>

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, discussed at the October hearing and at last year's hearing as well, should be carefully considered, along with other initiatives to enhance sustainable development objectives.

Transportation emissions are a major contribution to overall greenhouse gas (GHG) emissions and a recognized danger to the environment. With a monopoly motor vehicle insurer, Manitoba has an opportunity to utilize the premium system as well as a new Driver Safety Rating program to encourage reduced discretionary driving, and the choice of vehicle.

The SDA requires all public bodies to pursue environmental objectives; MPI and the Public Utilities Board, though a Crown Corporation and a quasi judicial administrative tribunal, respectively, are among that number.

<u>Interveners</u>

CAC/MSOS:

The Board is in fundamental agreement with CAC/MSOS with respect to several major areas of interest:

a) the Risk Analysis and the VAR, performed using the approach and major assumptions of past proceedings, should remain the key support for the Board's RSR range, though the Board has no difficulty with MPI utilizing MCT/DCAT for trend and "early warning" indicator purposes;

b) the Board's "lower" RSR range is adequate; the MCT-based range is rejected (As CAC/MSOS stated ".. the MCT was created by a different regulator with a different mandate in a different competitive context, for a different purpose...MCT is a good tool for a busy regulator supervising a hundred and ninety companies … in a competitive market.");
c) budgeting for a loss is to be avoided, and resorting to surcharges to rebuild the RSR when necessary remains an acceptable and available mechanism (the purpose of the RSR is not to protect against even low probabilities of surcharge conditions);
d) too high a RSR risks less rigorous fiscal accountability and planning; and
e) the importance of effective driver training and education.

The Board disagrees with CAC/MSOS as to the general acceptability of MPI's premium proposal, the average 2.6% decrease. The Board continues to accept MPI's IIF approach while also accepting the need for an ERP in forecasting expected future investment earnings from the equity segment of the investment portfolio.

Finally, the Board disagrees with CAC/MSOS' perspective on MPI's immobilizer project, which includes a pessimistic view of forecast future results to arise from it. The Board notes progress, and, in an action that further supports prospects for the initiative, will give consideration to premium surcharges against recalcitrant owners of "top 150" vehicles, if such a request is advanced by MPI.

CMMG

The Board shares several of CMMG's perspectives:

a) the significance of the relationship between Extension, SRE and Basic operations, as CMMG stated "Autopac extension and SRE customers are also basic customers. If rebates flow from those sources, they will be going to a group of basic customers.");

b) as to the Board's regulatory tradition (Board Order 179/01: "Any future decisions of the Board that impact the level of the RSR will be made taking into account the overall financial wellness of the Corporation.");
c) as to the method of arriving at the Board's RSR range and RSR adequacy;
d) MPI's accounting, particularly with respect to providing for future claims payments and costs, is at least adequate (claim reserving, IBNR, PfAD, discount rate – each provision and assumption subject to internal and external professional accounting and actuarial review);
e) as to the planning that precedes major program changes, potentially affecting the RSR (CMMG: "(CMMG) does not believe any(one) … so naïve (to) believe .. changes merely drop from the sky at the whimsy of the government.");
f) as to the importance of monitoring and controlling operating costs, towards assuring program cost effectiveness (CMMG: ".. MPI had increased staff by 129 positions in the last number of years… outside of (not including) the addition of DVL.");
g) the investment risk of a conservatively structured investment portfolio can be expected to decrease with time;
h) an ERP should be included in forecasting investment income;
i) a counter-balance exists with respect to interest rate changes for an insurer (interest rate increases depress the market value of a fixed-income based investment portfolio while also decreasing claims liabilities);
j) in considering changes to the reinsurance program, MPI should take into account not only projected cost savings but also the prospective impact on the RSR;
k) motorcycle driver training, education and driving behaviour are important factors in the frequency and severity of motorcyclist injuries and deaths, and require increased attention by MPI;
l) Basic program coverage limits require annual review for adequacy;
m) the interplay of the employment of CLEAR, vintaging and appropriate rate groups requires closer review at a future Board MPI General Rate Application hearing;
n) the Board-approved loss transfer methodology should be extended to collision in due course;

o) the factors surrounding single vehicle motorcycle accidents require further identification and study;
p) brokers should be provided information on motorcycle values, to assist policyholders in the declaration of values for insurance purposes); and
q) MPI should avail itself of the opportunity to involve CMMG in considering and planning the approach taken to motorcycles with respect to classification, education and training.

MUCDA

The Board agrees with MUCDA:
a) in an overall sense, the risk profile of MPI has not changed significantly;
b) the Board's RSR range is adequate;
c) auto theft is a serious crime with violent connotations; and auto theft may facilitate the commission of other criminal offences.

The Board shares MUCDA's concern that as the percentage of "most at risk" vehicles with immobilizers rises, other non-immobilized vehicles will come to be at higher risk of auto theft. Accordingly, the Board supports MUCDA suggestion that MPI regularly review the composition of its "most at risk" list and amend it with additions as may be required.

CAA

The Board shares CAA's awareness of the support provided in the past by CAA and other interveners for rate increases, and surcharges to rebuild the RSR, as such were required. The Board notes that CAA has consistently indicated interest in and support for a financially strong MPI, calling for balanced budgets even when to develop or maintain that strength higher rates were necessitated.

The Board recalls with CAA past events suggesting less than a perfect and continuous MPI understanding as to the source of its excess funds, an example being MPI's suggestion that excess retained earnings be donated to Manitoba universities rather than be returned to policyholders in the form of a rebate. And, the Board agrees with CAA that the rebate precedent is as established as surcharges and premium increases, each as and when supported by the level of the RSR and forward budget forecasts.

The Board also shares CAA's concerns with respect to MPI's current intention not to continue the transfer of excess Extension and SRE retained earnings to the RSR, noting with CAA that Extension and Basic are inextricably linked. The Board joins CAA in recommending to government that Extension and SRE rates and service be made subject to the same level of oversight the Board exercises over Basic.

MBA

The Board shares MBA's reservations about MPI partially funding government programs, which is currently the case with respect to the anti-theft initiative. Funding the WPS' auto crime unit would be, in the absence of a striking circumstance such as the level of auto theft in Winnipeg, particularly problematic, so would the support provided by MPI to Manitoba Justice with respect to prosecutors and probation officers. There is a difference between funding driver education and training programs (such as operated by the Manitoba Safety Council) and meeting the costs of tax supported government agencies mandated to perform certain functions.

MBA's cross-examination and closing argument focused in part on MPI's treatment of claimants. MBA is correct in its vigilance related to such matters; MPI may perceive itself as having many similarities to other insurers operating in the motor vehicle field, but there are substantial differences and these extend to the overall purpose of the organization. MPI is a Crown Corporation mandated by legislation to fairly compensate and treat claimants and those injured by motor vehicle accidents. Returning a profit on the investment of a parent company is not one of MPI's objectives; the Corporation has been fully funded by its policyholders and the Province has not sought a dividend.

The Board agrees with MBA as to the importance of particular Board directives in Order 148/04 and, a year later, 150/05:

Order 148/04:

"Manitoba Public Insurance (is to) develop claim benchmarks for duration, frequency and costs for comparison with its own experience and that of other no fault jurisdictions and agencies; and file a summary of the benchmarks with the Board.."

Order 150/05:

"Develop claims handling, PIPP and other operating 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."

As MBA stated at the hearing, MPI did not file the required report(s) for either the 2005 or this rate hearing, citing other priorities. MPI gave evidence at this hearing that it intends to develop the benchmarks, and extend its research beyond other no fault jurisdictions, ahead of next year's General Rate Application.

Each year, MPI expends over $200 million in direct PIPP claim payments, with IBNR and PfAD provisions, PIPP represents the largest component of MPI's Unpaid Claims liability. PIPP accounts for the largest share of the indicated premium rate for vehicles each year. Overall, MPI expends or provides to expend in the future over $600 million; this is a considerable amount of money, money with a common origin- the premiums of policyholders.

For many reasons, MPI should develop the benchmarks called for in Orders 148/04 and 150/05.

Without benchmarks to test actual experience against, it is difficult to be fully assured that MPI is handling and managing claims in an effective fashion. That MPI's general operations are as reasonably cost effective as they should be, and as comparable as possible with the best experience found in other jurisdictions.

Without that assurance, there will always be an element of doubt as to whether current premium levels are higher or lower than effective and fair treatment and management should provide.

MBA's comments on the RSR, focused on the purpose of the RSR, were thought-provoking, and the Board agrees that without a common understanding as to its purpose, each year's hearing is likely to repeat old themes. For this and other reasons, the Board has elaborated in some detail its views concerning the RSR in this Order.

<u>MCA</u>

The Board agrees with MCA that establishing appropriate rates begins with appropriate attention to ensuring claimants receive the benefits they are entitled to, and in a responsive, fair and service-effective manner. While the Board is not convinced there are systemic problems associated with MPI's approach, the Board is concerned with the absence of benchmarks to test actual experience against internal and external comparative norms, without benchmarks complete assurance is not possible.

However, there was no evidence presented suggesting MPI's claims of client-focus were untrue. Nor was evidence presented that the objectives set for the program with respect to providing superior automobile insurance coverage and service and responsive, fair, courteous and convenient customer service were not being accomplished. The Board, as did several interveners, found MPI's panel of witnesses, primarily members of the Corporation's executive team, sincere and interested in claimant well-being, subject to the parameters of the Basic program as set by legislation and regulation.

In MCA's closing remarks, reference was made to the funding base for MCA's participation in the hearing proceedings, with a suggestion that its counsel was dependent upon a cost award by this Board for compensation for efforts expended in advancing MCA's interests at the hearing.

While the Board may award costs to interveners, there are criteria to be met and the final decision rests solely with the Board and is not made in advance of a hearing. Cost awards are not generally made to parties deemed capable of funding participation, particularly not to commercial interests. The members of MCA are service providers to MPI, and the payments by MPI to MCA members each year are material. The Board made its criteria clear at the outset of the proceedings, and the criteria are available from the Board's Office and through access to its web site.

RCM/TREE

The Board joins RCM/TREE in the interveners' interest in the advancement of a sustainable society and economy in Manitoba. The Board agrees with RCM/TREE that the Board, MPI and other Crown agencies are subject to the Sustainable Development Act, and should pursue the achievement of the objectives of that Act.

The Board also agrees with RCM/TREE that premiums established should reflect the public interest. The question is whether that interest includes the setting of premiums reflecting goals other than the reflection of cost causation. If the answer to that question is yes, then MPI's interest in concepts such as PAYD (pay as you drive), wherein premiums are established based in part on kilometres travelled, would presumably increase. As well, possibly MPI would consider including fuel economy as a factor in rate setting.

While the Board joins RCM/TREE in recognizing MPI's laudable though initial efforts to integrate sustainability principles into the operations of its internal departments, MPI's major contribution to sustainability could potentially lie through the employment of its premium setting model and with the upcoming Driver Safety Rating program.

As RCM/TREE advanced, climate change mitigation has become a "signature policy" of the provincial government and emissions caused by motor vehicles have been attributed responsibility for almost a third of GHG emissions in Manitoba. As well, clearly safety and reduced accidents and injuries are consistent with sustainability.

The Board joins RCM/TREE in recommending to MPI that it pursue with increased vigour an understanding of PAYD concepts and potentially applicability. As RCM/TREE advanced, the understandings need to be advanced "… by investigations into relationships between risk and distance, the elasticity of driving behaviour subject to economic incentives, and examples of implementation…". The Board agrees with RCM/TREE in suggesting to MPI that "… if (it) does not have the time or inclination to conduct these investigations ... commission the research to be done by others. Where there's a will there's a way, at least to gather the information needed for informed policies and decisions."

MPI should take RCM/TREE's advice and seek clarification of its sustainability mandate from the government and report on its findings as well as its research and related undertakings at the next General Rate Application.

Scootering Manitoba

The Board agrees with SM that MPI's proposal to reduce motor scooter premiums by 94% after years of increases being applied suggests that while much has been done over the years to improve the classification and premium setting model, it is clear that more work likely remains ahead. Presenter Hyworren raised an issue related to newspaper carriers that may represent this sort of matter. Through this hearing and other processes, MPI learns of issues for its policyholders, issues that when researched thoroughly, may lead to changes that reflect increased fairness.

A further example of this arising out of SM's intervention to these proceedings is MPI's separation of rental mopeds from individually owned mopeds; a move expected to improve the relationship between cost causation and premiums for mopeds.

The Board joins with SM in recognizing that outdated legislation and insurance definitions should be addressed, and recommends to MPI that it bring these matters to government's attention with its support.

Fraser Institute

During the time of the public hearing, the Fraser Institute (Fraser), an independent economic "think tank," published Auto Insurance Market Quality Index 2006: Annual Comparison of International Auto Insurance Markets (study).

The study surveyed 60 state and provincial American and Canadian jurisdictions, as well the auto insurance market of the United Kingdom, with respect to passenger vehicles. Through testing 2002 information against criteria developed by Fraser, the organization concluded that Manitoba and the other Canadian public auto insurance markets "consistently produce the worst outcomes for consumers."

The Board enquired of MPI as to whether the Corporation wanted to respond to the study, and it did so through a letter very critical of Fraser's study to the editor of the Winnipeg Free Press, filed with the Board at the hearing. This Board also reviewed Fraser's study, independent of MPI.

While the Board does not normally comment on outside studies of MPI's programming not tested through the General Rate Application process, the serious nature of Fraser Institute's assertions require comment.

The outcome of Fraser's study was driven by the selected criteria, most of which tested for "independent choice" and "lack of regulation." The study provided its highest ratings to largely unregulated American jurisdictions that set premiums based on factors including age, sex and fault, while requiring no or minimum coverage levels for accident benefit, property damage, medical benefits or liability. The study ignored substantial benefits to policyholders and all Manitoba residents that are delivered by MPI but are outside of those found with private motor vehicle insurers. These additional benefits include motor vehicle accident coverage in the United States and other Canadian jurisdictions whether or not a MPI policyholder; the value of MPI's investments in municipal infrastructure; economic development assists and the particular ability of a monopoly to pursue general road safety objectives.

In summary, the Board concludes Fraser's study was wrong in concluding Canada's monopoly public auto insurers "produce the worst outcome for consumers." This is particularly the case as to Fraser's assertions with respect to the Manitoba program.

4.0 IT IS THEREFORE RECOMMENDED THAT MPI:

1. Monitor the results of the voluntary immobilizer program and regularly review the "most at risk" (of auto theft) list, and adding to the list as required (objective: awareness of success of voluntary program and to adapt to changing circumstances);

2. Upon concluding that the voluntary immobilizer installation program will not or is at risk of not reaching its objective, make special application to the Board for premium surcharges against vehicles on the "most at risk" list for which immobilizers have not be installed (objective: reduce accidents, injuries and fatalities and improve premium equity through achieving success with the anti-theft initiative);

3. Develop claims handling, PIPP and operating cost benchmarks, and perform analyses trending developments and comparing MPI experience with that of other comparable insurers (objective: provide analytical tools to guide operating actions and further program and cost effectiveness);

4. Further the analysis of the major cost drivers of accidents and injuries, and file a report with the Board ahead of next year's General Rate Application (objective: understand causal factors of accidents to assist in planning and implementing driver education and training and the Driver Safety Rating programs);

5. Commission an independent review, either internally or externally supported, of the current accident prevention and driver education program, seeking ways and means to bring down accident and injury frequency and severity while ensuring program cost effectiveness (objective: better ensure program and cost effectiveness);

6. Develop and provide a report to the Board ahead of next year's General Rate Application on the experience and prospects for graduated licensing (objective:

assist in evaluating graduated licensing to develop recommendations for improvements and/or enhancements);

7. Consult with policing agencies and the Province to understand the linkages between accidents and traffic law enforcement and consider the implications and related options with respect to Board-perceived diminished traffic enforcement (objective: bring down accident counts, improve road safety and further premium equity between drivers with differing driving experiences and approaches);

8. Consult with policing agencies to address perceived diminished traffic enforcement (objective: develop options to improve traffic enforcement towards improving road safety);

9. Support the Board's recommendation to government, issued herein, that Extension and SRE divisions be brought within the Board's regulatory oversight (objective: enhance the value to policyholders of Board oversight and processes);

10. Transfer DVL operations, including its financial aspects, from the Extension division to Basic insurance operations (objective: recognize the integral nature of DVL operations within basic);

11. Further diversify the investment portfolio and forecast investment income employing an ERP of 1.5% (objective: improve future yields and establish reasonable forecasts based on equity investment plans);

12. Discuss with government a discontinuation of investment management fees to the Province for the portion of the portfolio invested in Province of Manitoba securities;

13. Support with government, the Board's recommendation that the Province cease charging investment management fees to MPI on the portion of MPI's portfolio invested in Province of Manitoba securities (objective: remove a perceived conflict of interest with a related party);

14. Seek the government's perspective on the possible use of the classification and rate setting model to further the reduction of GHG emissions (objective: determine the extent of MPI's contribution to environmental sustainability);

15. Undertake serious research into the PAYD concept (objective: determine the potential efficacy of implementing a trial PAYD program, to assist with environmental sustainability);

16. Consult with CMMG and SM to identify and resolve, as best as possible, with the co-operation of government as may be required, definition, coverage and claim attribution issues related to motorcycles (objective: enhancement of efficacy and fairness of classification and rate model);

17. Reconsider the merits of not allocating operating costs against trailers and off-road vehicles (objective: assurance of a fair rate model); and

18. Review hearing presentations, and provide responses to the presenters with copies to the Board.

5.0 BOARD DIRECTIVES:

BE IT ORDERED THAT:

1. MPI's proposed 2.6% overall decrease in Basic motor vehicle premiums and fees for the Basic Automobile Insurance Program for the year ending February 28, 2008 be and is hereby approved, except for the following amendments:
   a) reduce the average increase in motorcycle rates to 5% rather than the proposed 8.4%; and
   b) cap increases in moped premium rates at 25% per annum, while retaining the 20% cap for increases for other vehicles (no cap for motor scooter premium decreases),

   the amendments to be made without affecting premiums for any other class or vehicle.

2. the RSR range for Basic Insurance for ratesetting purposes be reset to $69 million to $105 million, with the IIF to continue to be a component of RSR for purposes of assessing RSR adequacy.

3. MPI provide a premium rebate of 10% to all policyholders who paid Basic compulsory insurance premiums in the 2005/06 insurance year. Premiums paid for 2005/06 is defined to be all Basic compulsory premiums written during 2005/06, net of any premium refunds and after any fleet rebates; the rebate is to be paid separate from the premium collection process.

4. MPI provide an update to the Board on or before June 30, 2007 on:
   a) its BPR;
   b) Auto-theft initiatives; and
   c) Results, efforts and considerations with respect to the Board's recommendations.

The Public Utilities Board

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

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

Certified a true copy of
Order No. 156/06 issued by
The Public Utilities Board

Secretary

Appendix A

Appearances

Walter Saranchuk, Q.C. Candace Everard	Counsel for The Manitoba Public Utilities Board
Kevin McCulloch	Counsel for Manitoba Public Insurance Corporation
Michael Mager Jeannie Dalman Donna Wankling	Representing the Canadian Automobile Association (Manitoba Division)
Pamela Reilly	Counsel for Manitoba Chiropractor's Association
Raymond Oakes	Counsel for the Coalition of Manitoba Motorcycle Groups
Myfanwy Bowman Byron Williams	Counsel for the Consumers' Association of Canada (Manitoba) Inc./ Manitoba Society of Seniors
Patricia Fitzpatrick Randall McQuaker Peter Miller	Resource Conservation Manitoba/Time to Respect Earth's Ecosystem
Robert Dawson	Counsel for the Manitoba Bar Association
Claudio Sousa	Representing Scootering Manitoba
Nick Roberts	Representing Manitoba Used Car Dealers Association

Appendix B

Witnesses for MPI

Marilyn McLaren	President and Chief Executive Officer
Barry Galenzoski	Vice-President, Corporate Finance
Wilf Bedard	Vice-President, Claims
Don Palmer	Chief Actuary and Director, Pricing and Economics
James Christie	Actuary, Ernst and Young

Witnesses for CAC/MSOS

Professors Hum and Simpson	University of Manitoba

Appendix C

Interveners

Canadian Automobile Association - Manitoba Division

Manitoba Chiropractors Association

Coalition of Manitoba Motorcycle Groups

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

Manitoba Bar Association

Manitoba Used Car Dealers Association

Resource Conservation Manitoba/Time to Respect Earth's Ecosystem

Scootering Manitoba

Presenters

Michelle Gibb

Antoine Hacault, President, Manitoba Bar Association

Doug Houghton

Amanda Hyworren

Graeme Keiller

Brent McNaught, Vespa Winnipeg

Warren Mills

Edward Toker, (by letter only)