MANITOBA	Board Order 173/03
THE PUBLIC UTILITIES BOARD ACT	
THE MANITOBA PUBLIC INSURANCE ACT	
THE CROWN CORPORATIONS PUBLIC REVIEW AND ACCOUNTABILITY ACT	December 4, 2003

Before: G. D. Forrest, Chair
D. Côté, Member
E. Jorgensen, Member

AN APPLICATION BY MANITOBA PUBLIC INSURANCE FOR AN ORDER APPROVING COMPULSORY DRIVER AND VEHICLE INSURANCE PREMIUMS FOR THE YEAR ENDED FEBRUARY 28, 2005

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Executive Summary

The Manitoba Public Insurance Corporation ("MPI") filed an application with The Public Utilities Board ("the Board") on June 18, 2003 for approval of premiums to be charged for compulsory driver and vehicle insurance ("Basic insurance") for the insurance year commencing March 1, 2004 and ending February 28, 2005 ("fiscal 2005").

MPI requested an increase in overall vehicle premium revenue of 2.5%. The application reflects a revised forecasted net loss of $1.3 million for the year ending February 29, 2004 ("fiscal 2004") and projects a net loss of $13.8 million for fiscal 2005. MPI's current forecasts show that the actuarially indicated rate increases required are 4.3% in fiscal 2005, 1.2% in fiscal 2006, and 0.4% in fiscal 2007. Given the fluctuation in the indicated rate changes for each of those three years, MPI proposed smoothing the rate increase by applying for a 2.5% increase in this application with the future intention of seeking similar increases in each of the next two years assuming current forecasts hold. MPI contends such an approach is possible because of its monopoly position and reflects its long term commitment to rate stability.

MPI did not request any changes for driver licence premiums, service and transaction fees, and permit and certificate fees.

Premium revenues for fiscal 2004 are forecast to be $523.4 million. With the applied for rate increase in fiscal 2005 of 2.5%, premium revenues are projected to increase by $32.1 million to $555.5 million. MPI assumed a 3.5% vehicle upgrade factor and a 1% increase in the size of the vehicle population. The Board found these assumptions to be reasonable.

MPI's claims forecasting methodology remains unchanged from last year. In MPI's Financial Forecast approach, the cost of claims incurred for fiscal 2004 is forecast to be $470.8 million, with a projected increase in costs of $41.5 million for a total claims forecast for fiscal 2005 of $512.2 million. Physical damage claims are projected to increase by $19.1 million, of which $13.7 million is attributable to increased collision claims costs. Personal Injury Protection Plan

accident benefits and weekly indemnity payments are expected to increase by approximately $21.1 million to $210.5 million for fiscal 2005. Claims expenses, operating and other expenses, commissions and premium taxes are expected to increase by approximately 6.9%.

In the Board's view, MPI continues to show a reasonable degree of forecasting accuracy, over the long-term. However, the Board is concerned with the large variances between projected and actual claims incurred in fiscal 2002 when the claims experience was $45.4 million or 10.5% higher than projected. In fiscal 2003, the claims experience was $26.9 million or 5.8% greater than forecast. The Board noted that while the experience over this two year period may not be sufficient to indicate a permanent change in trends, nonetheless some emerging factors could be adversely impacting future claims costs. As well, investment income which is used to offset underwriting loss from insurance operations declined from an estimated $62.2 million to $44.1 million in fiscal 2003. MPI is currently forecasting investment income to be $61.5 million in fiscal 2004, increasing to $67.3 million in fiscal 2005.

Depending on the assumed frequency of serious loss counts, the Board is concerned that an updated fiscal 2004 Statement of Operations filed during the hearing may be indicating further adverse claims development ranging from $23.3 million to $43.6 million. The Board noted that any adverse development would have a direct and negative impact on the $1.3 million net loss currently forecast for fiscal 2004.

With MPI budgeting for a net loss in its GRA of $13.8 million for fiscal 2005, the Board reiterated its earlier position that MPI should, at a minimum, budget for a break-even position for the year of the application. Given the uncertainty inherent in forecasting, a break-even position does not necessarily mean achieving a zero net income. However, the Board considers the projected net loss of $13.8 million for fiscal 2005 to exceed the limits of a break-even position.

The Board considers MPI's proposal to smooth rates over future years to be inappropriate in that costs of current claims experience would be paid by future ratepayers. Given the recent adverse experience in claims incurred and the current volatility in investment income and in forecasting,

the Board views MPI's application for a 2.5% increase as unduly exposing Manitoba motorists to larger increases in the future to cover ever escalating claims costs and a further depleted Rate Stabilization Reserve ("RSR"). As stated by the Board in previous GRAs, the appropriate RSR target range for rate setting purposes is between $50 million and $80 million. MPI's Board of Directors maintains the range ought to be $80 million to $100 million while it is committed to transferring to the Basic RSR funds in excess of certain levels of retained earnings in MPI's Special Risk Extension ("SRE") and Extension divisions. The transfer from SRE for fiscal 2004 was $4.0 million, and is projected to be $1.6 million in fiscal 2005, although in last year's GRA, MPI had forecasted an SRE transfer of $3.0 million. If the applied for rates were approved, the forecast for the RSR level is $38.2 million for fiscal 2004, and down to $25.9 million for fiscal 2005, with both amounts well below the Board's minimum RSR target of $50 million.

MPI indicated the actuarially indicated rate for fiscal 2005 was 4.3% assuming a consumer price index ("CPI") of 3.0%. Although reasonable at the time of submitting its GRA, the Board considers that CPI figure to be excessive. The Board noted that recent forecasts by the Governor of the Bank of Canada and various consensus forecasts indicate a CPI of 2% as being more likely.

Bearing in mind a CPI of 2%, the Board estimates a premium revenue increase of 3.7% affords MPI with a better opportunity of achieving a break-even net income in fiscal 2005. It will also ward off any further deterioration in the current RSR level. The Board ordered MPI to refile its rate schedules and related documents including Major Vehicle Class impacts to reflect the increase of 3.7% in overall vehicle premium revenue in fiscal 2005.

At the hearing, evidence was presented relative to the possible adoption of a loss transfer mechanism as an alternative to MPI's current method of calculating premium levels based on costs attributed to Major Vehicle Classes, regardless of fault. Upon review of the issues surrounding the adoption of a loss transfer model, the Board determined that there was no compelling reason to abandon the current system of assigning costs on a first party basis in favour of a loss transfer model.

The Board is concerned with the magnitude of required motorcycle rate increases experienced over the past decade. Notwithstanding annual increases of approximately 15% to the Motorcycle Class over that period, current motorcycle rates still remain well below the actuarially indicated rate. This is primarily due to serious losses in that class. The Board has not been persuaded that claims costs and expenses paid to or on behalf of members of any Major Class should be borne by members other than from that class. MPI and the Board wish to halt the cross-subsidization of the Motorcycle Class by other classes.

Rather than applying experience-based adjustments to the Motorcycle Class in fiscal 2005, MPI opted to combine rate increases in the rate line differentials according to the actuarially indicated requirements, while capping individual rate group increases at 30%. The Board, however, limited the capping to 20% which will result in a 14.91% average overall increase in motorcycle premiums rather than the 19.93% which MPI originally proposed.

A report on MPI's road safety program as well as recommendations by various stakeholders in response to that report was reviewed by the Board. The Board is encouraged with the responses received and would like to see all stakeholders taking an active role in advancing their respective areas of expertise with a view to ameliorating road safety and thus eventually reducing insurance costs for Manitoba motorists.

1.0 Appearances

W. S. Saranchuk, Q.C. K. L. Kalinowsky	Counsel for The Manitoba Public Utilities Board ("the Board")
K. McCulloch	Counsel for Manitoba Public Insurance Corporation ("MPI")
J. W. Kruk	Representing the Canadian Automobile Association (Manitoba Division) ("CAA")
R. P. Oakes	Counsel for the Coalition of Manitoba Motorcycle Groups ("CMMG")
B. Williams	Counsel for the Consumers' Association of Canada (Manitoba) Inc./ Manitoba Society of Seniors ("CAC/MSOS")
M. Scurfield	Representing the Insurance Brokers Association of Manitoba ("IBAM")
J. E. Foran, Q.C.	Counsel for the Manitoba Car and Truck Rental Association ("MCTRA")

2.0 Witnesses

2.1 Witnesses for MPI

J. W. Zacharias	President and Chief Executive Officer
M. J. McLaren	Vice-President, Corporate Insurance Operations
B. W. Galenzoski	Vice-President, Corporate Finance, Chief Financial Officer and Chief Administrative Officer
W. L. Bedard	Vice-President, Claims

2.2 Witness for MCTRA

P. J. Wintemute, FCA	Chairman and Chief Executive Officer, The Exchange Group

3.0 Intervenors

Canadian Automobile Association - Manitoba Division

Coalition of Manitoba Motorcycle Groups

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

Insurance Brokers Association of Manitoba

Manitoba Car and Truck Rental Association

4.0 Application

MPI applied to the Board on June 18, 2003 for approval of premiums to be charged for compulsory vehicle and driver insurance ("Basic insurance") for the fiscal year commencing March 1, 2004 and ending February 28, 2005 ("fiscal 2005") pursuant to The Crown Corporations Public Review and Accountability Act, The Public Utilities Board Act, and The Manitoba Public Insurance Corporation Act.

In this general rate application ("GRA") MPI requests an overall increase in revenue of 2.5%. The application provides for a revised forecasted net loss for the year ending February 29, 2004 ("fiscal 2004") of $1.3 million and projects net loss for fiscal 2005 of $13.8 million.

This GRA reflects a change in approach from previous applications. While only seeking a rate increase for the year of the application, MPI requests that actuarially indicated rate requirements for the two years beyond the application year be considered by the Board when assessing the adequacy of the fiscal 2005 rates. MPI's current forecast shows that the actuarially indicated rate increase required in fiscal 2005 is 4.3%. The projected rates in fiscal 2006 and fiscal 2007 are 1.2% and 0.4%. Given the variance in the indicated rates for each of those three years, MPI intends to smooth the annual rate changes by applying for a 2.5% increase in this application while projecting an identical increase in each of the next two years if the current projections hold. MPI attributes this new approach in its application to its monopoly position and long-term commitment to rate stability.

Premiums for all Major Vehicle Classes, with the exception of motorcycles this year, continue to include experience adjustments that are capped between -15% and +15%, by applying the same experience adjustment rules that were used in previous GRA's. As was the case last year, classification offsets were applied to achieve revenue neutrality in implementing rate group

adjustments. MPI is proposing a change to the premium revenue for motorcycles by applying an adjustment to the rate line relativities rather than utilizing experience based adjustments.

MPI made no request for changes to the Driver Licence Premiums, Service and Transaction Fees, and Permit and Certificate Fees.

The Board held a pre-hearing conference on June 27, 2003 to consider procedural and other issues relating to the application. Following the pre-hearing conference, the Board issued Order 111/03 dated July 3, 2003, granting Intervenor status to the applicants and establishing a procedural timetable for the orderly exchange of information and procedures to be followed.

On September 29, 2003, the Board heard motions by MCTRA and CMMG to compel full and better responses to information requests of MPI, at the conclusion of which the Board issued Order 145/03 dated October 6, 2003.

The public hearing of MPI's rate application was held for seven days between October 14 and October 24. The Board heard final arguments on October 31, 2003.

5.0 Program Revenue

5.1 Forecasted/Projected Operating Results

MPI relies on four main sources of revenue to fund the Basic Insurance Program being: motor vehicle premiums, drivers' premiums, investment income, service transaction fees and other miscellaneous revenue. MPI's forecast of operating results for fiscal 2004 based on existing rates and projection for fiscal 2005 based on requested rates are as follows:

Statement of Operations ($ millions) For Years Ending February 28/29,	**Fiscal 2004 at Existing Rates $**	**Fiscal 2005 at Requested Rates $**
Net premiums earned		
Motor vehicle premiums	523.4	555.5
Drivers' premiums	33.1	33.1
Reinsurance ceded	(10.9)	(11.2)
	545.6	577.4
Service fees and other revenues	13.6	15.5
Total earned revenue	559.2	592.9
Net claims incurred	470.8	512.2
Claims expense	64.9	69.1
Road safety/loss prevention	6.9	7.2
Total claims costs	542.6	588.5
Expenses		
Operating	36.7	39.7
Commissions	24.1	25.5
Premium taxes	16.7	17.6
Other regulatory/appeal	1.9	2.7
Total claims and expenses	622.0	674.0
Underwriting loss	(62.8)	(81.1)
Investment income	61.5	67.3
Net loss	(1.3)	(13.8)

5.2 Motor Vehicle Premiums

Motor vehicle premiums are based on rating territory, insurance use, rate group, and the registered owner's driving record. Vehicle premiums historically comprise about 80% of the total revenue for the Basic Insurance Program. In last year's GRA, the projection for motor vehicle premiums earned for fiscal 2004 was $526.6 million, and were revised in the current application to $523.4 million, a decrease of $3.2 million. In fiscal 2005, motor vehicle premiums earned are projected to increase to $555.5 million. MPI is applying for a 2.5% increase in overall vehicle premiums in this GRA.

5.3 Drivers' Premiums

All Manitoba motorists are assessed a basic premium on their drivers' licences based on the principle that all drivers should contribute premiums to the insurance fund, regardless of whether they own and insure a vehicle. The drivers' licence premium is $45 and can be reduced by $5 for each merit point that the driver has earned up to a maximum of 5 merit points, or a $25 reduction. The drivers' licence premium has been $45 since 1997. When considering an increase in driver's licence premiums, MPI considers the length of time since the last premium increase, the size and frequency of recent vehicle premium increases, public acceptability, and general affordability.

Additional premiums are assessed against motorists who have accumulated six or more demerit points on their driver's licence, since conviction-prone drivers represent a higher level of risk. Accident surcharges are intended to deter accidents and to require accident-prone drivers to pay a larger share of overall insurance costs. The surcharge increases with the number of accidents.

Total forecasted revenue for drivers' licence premiums, demerit point additional premiums and accident surcharges for fiscal 2005 is $33.1 million, which is virtually unchanged from

fiscal 2004. There are no proposed changes to the drivers' licence premiums or accident surcharges in this application.

5.4 Service Fees and Other Revenues

The Basic Insurance Program is forecasted to earn $13.6 million from service fees and other revenue in fiscal 2004 and is projected to be $15.5 million in fiscal 2005. This revenue consists mainly of income from time payment plans, late fees, dishonoured payment fees and miscellaneous fees. No changes are requested in the current application for service fees and other revenue.

5.5 Investment Income

February 28, 2003, MPI had investments totalling $1.1 billion. Income earned from its investment portfolio reduces the premium revenue MPI is required to collect. MPI is projecting Basic's share of investment income at $67.3 million for fiscal 2005, which represents approximately 83% of total investment income.

Actual investment income for fiscal 2003 was $44.1 million, a decrease of $18.1 million from the revised forecasted investment income of $62.2 million. The negative variance was mainly due to lower than expected earnings from the equity investment portfolio resulting from a decrease in the S&P 500 total return index during the year offset by gains from the bond portfolio.

At the time of the filing, investment income for fiscal 2004 was forecasted to be $61.5 million; a decrease of $3.2 million from the projection at last year's GRA. MPI attributed this change to the ongoing decline and uncertainty in the equity markets with equity income expected to decrease. Interest income on short-term investments is also anticipated to be lower than expected.

6.0 Program Costs

MPI forecasts for fiscal 2004 and projects for fiscal 2005 costs for the Basic Insurance Program as follows:

($ millions)	Forecasted Expenses 2004	Projected Expenses 2005	Percentage of Total 2005
Claims Incurred	$470.7	512.2	76.0%
Claims Expenses	64.9	69.1	10.2
Road Safety/Loss Prevention	6.9	7.1	1.1
Operating Expenses	36.7	39.7	5.9
Commissions	24.1	25.5	3.8
Premium Taxes	16.7	17.7	2.6
Regulatory and Appeal Expenses	1.9	2.7	0.4
	$621.9	674.0	100.0%

6.1 Claims Incurred

As indicated in the above table, claims incurred is the largest component of costs for the Basic Program, and for fiscal 2005 is projected to be approximately 76.0% of the Basic Program's total costs compared to 75.7% for fiscal 2004. Claims incurred represents the total benefits paid or expected to be paid by MPI on account of claims incurred under the Basic Insurance Program. The following table shows a five-year comparison for total claims incurred and by cover commencing in fiscal 2001.

Claims Incurred

Five Year Comparison ($ millions)

Fiscal Year ending	2001	2002	2003	2004	2005	Five Year Change $	Five Year Change %
Physical Damage							
Collision	$155.1	167.4	185.4	191.8	205.5	50.4	33%
Comprehensive	43.4	59.8	50.5	53.6	57.6	14.1	32%
Property Damage	25.1	26.5	29.4	28.5	29.9	4.8	19%
	223.6	253.7	265.2	273.9	293.0	69.3	31%
No Fault Accident Benefits*	154.5	180.7	199.7	189.4	210.5	56.0	36%
Public Liability	-	(0.5)	2.8	7.4	8.7	8.8	-
Total	$378.1	433.9	467.7	470.7	512.2	134.1	35%
% of Basic Costs	74.3	76.3	76.6	75.7	76.0		

* Includes Pre-PIPP Claims Incurred

6.1.1 Claims Incurred Forecast and Projections

MPI continues to use the Financial Forecast Method to estimate claims incurred. Management judgment is one of the various factors used in the Financial Forecast Method. It also includes economic indicators, such as a forecasted 3.0% CPI for fiscal 2005. MPI contends that the Financial Forecast Method is actuarially based and statistically sound, although it continues to use the Linear and Exponential Methods of forecasting and projecting claims incurred in order to verify the results using the Financial Forecast Method. MPI has confirmed that both of these methods are actuarially based and statistically sound, and use historic data to determine future claims cost growth assumptions by cover.

For fiscal 2005, the Linear Method projected claims incurred of $503.2 million, the Exponential Method projected claims incurred of $522.3 million. The Financial Forecast Method used in this GRA projects claims incurred of $512.2 million.

The following table compares MPI's projections of claims incurred to actual results:

Claims Incurred Projection vs. Actual (in $ millions)

			Variance	
Fiscal Year	**Initial Projection $**	**Actual $**	**$**	**%**
1994	323.4	320.8	(2.6)	(0.8)
1995	290.2	297.8	7.6	2.6
1996	303.4	302.0*	(1.4)	(0.5)
1997	311.8	296.0	(15.8)	5.1
1998	322.6	340.8	18.2	5.6
1999	332.7	330.8	(1.9)	(0.6)
2000	365.3	352.7	(12.6)	(3.4)
2001	377.5	378.1	0.6	0.2
2002	388.5	433.9	45.4	10.5
2003	440.8	467.7	26.9	5.8

*A tort run-off adjustment increased the total actual to $352.3 million.
Since 1995, the variances include several other adjustments for tort run-off claims.

Variances occur because projections are forward-looking in nature and are initially prepared approximately 21 months prior to the end of the projection period. Factors impacting actual results are numerous, and include weather, prevailing economic and financial conditions, business trends, underwriting cycles, and changing driver and societal attitudes.

Two major factors contributed to the $26.9 million adverse variances for fiscal 2003: an increase in Personal Injury Protection Plan ("PIPP") claim severity of 27.8%, and an increase in collision

claims frequency of 2.7% over what was forecasted for fiscal 2004 last year. Relative to the revised fiscal 2003 forecast, actual claims incurred were $21.7 million (4.85%) higher, reflecting an increase in PIPP claim severity of 8.7% and an increase of 8.6% in collision claims frequency.

6.1.2 Physical Damage

Physical damage claims include all perils (collision and comprehensive claims) and property damage. All perils provides coverage for any direct accidental loss of or damage to an insured vehicle arising out of perils such as collision, fire, theft and hailstorms. Property damage claims relate to damage to property other than insured vehicles.

In total, physical damage claims for fiscal 2005 are projected to increase $19.1 million (7.0%) to $293.0 million compared to the $273.9 million forecast for fiscal 2004. The overall increase for the five-year period from fiscal 2001 to fiscal 2005 is estimated to be $69.3 million. The projections for fiscal 2005 assume a 1.7% increase in frequency and a 4.4% increase in severity.

Included in the $19.1 million increase in physical damage claims, is a $13.7 million increase in collision costs for damaged or written-off vehicles. The average annual year over year increase in collision claims since 2001 has been approximately 7.5%. The increase in collision costs is due to an increase in frequency of claims of 1.4% and an increase in severity of 5.7%. Similar to previous years, increases in severity are primarily driven by increases in price of original equipment manufactured parts, aftermarket and recycled parts. Cost increases are also expected because there are more new vehicles in the fleet, which are more costly to repair and/or replace.

Comprehensive claims costs are expected to total $57.6 million for fiscal 2005, an increase of 7.5% over 2004, reflecting a 4.7% increase in severity and 2.7% increase in frequency.

Property damage claims for fiscal 2005 are projected to be $29.9 million, $1.4 million (5.0%) greater than fiscal 2004. Property damage claims have remained relatively stable since 2000, and the 2005 forecast reflects this experience.

6.1.3 Personal Injury Protection Plan ("PIPP") Accident Benefits

PIPP accident benefits include weekly disability payments, death benefits, funeral and medical expenses and impairment benefits arising out of bodily injuries, regardless of fault. Benefits include payments under the previous tort system prior to March 1, 1994 and thereafter under the PIPP No-Fault System.

As the following table illustrates there have been significant variances between initial projections, revised estimates and actual results related to Accident Benefits. Variances reflect the fact that PIPP is relatively new and original estimates had little historical data upon which to rely in preparing estimates. This resulted in considerable fluctuation in year-to-year frequency and severity of claims for PIPP. Actual claims costs were higher than projections for several years after the inception of the PIPP plan, most notably in 1998. Increases from 2000 and 2003 reflect growth in frequency and severity for PIPP claims and indexation of benefits.

PIPP Accident Benefits ($ millions)

Fiscal Year End	Initial Projection	Revised Forecast	Actual
1995	$132.8	$119.4	$112.6
1996	140.2	126.6	105.3
1997	135.9	95.1	90.1
1998	118.8	115.5	132.7
1999	119.3	132.1	124.3
2000	139.0	136.3	144.0
2001	139.6	138.2	154.3
2002	139.8	162.2	182.4
2003	167.8	187.2	198.7
2004	190.1	189.6	-
2005	209.8	-	-

In response to a Board Information Request, MPI provided a breakdown of the various personal injury components of PIPP direct claims incurred, as shown below (in $ millions).

	Actual									Future		
Coverage	**1995**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
Income Replacement	23.4	24.7	18.5	47.5	31.2	70.8	51.2	71.0	88.4	74.8	77.1	82.0
Death Benefits	7.0	7.7	6.3	8.0	5.9	8.3	11.6	9.5	10.1	10.5	10.8	11.2
Permanent Impairment	5.6	6.8	8.9	12.5	11.5	11.3	13.7	13.7	17.3	19.3	20.6	21.9
Personal Care	32.0	13.6	(0.5)	23.2	21.8	23.7	21.8	21.4	31.2	33.8	33.5	33.1
Expenses/Rehabilitation	22.5	40.4	31.3	34.3	34.9	38.1	42.6	48.5	32.4	39.4	41.6	44.7
Total	90.5	93.2	64.5	125.5	105.3	152.2	141.0	164.2	179.5	177.8	183.6	192.9

MPI stated that the income replacement portion of PIPP claims experienced the largest increase since 1995. This was primarily a result of an increase due to the introduction of retirement income benefits in fiscal 2000, and claims paid for income replacement for longer periods of time. The retirement income benefits program provides income replacement for the life of the claimant, rather than the original plan that required full payment to age 65, then declining to zero by age 69.

Other variances and increases in costs result from statutory indexation, the random occurrence of large losses in excess of $500,000, which can vary from 10 to 25 occurrences in any given year, and required adjustments to case reserves at any point in time.

6.1.4 PIPP Third Party Liability

Claims costs for third party liability are projected to increase from the $7.4 million forecast for fiscal 2004 to $8.7 million for fiscal 2005. These claims include compensation paid on a third party basis to individuals injured by Manitoba motorists in accidents occurring outside Manitoba. A high variability in these claims can be expected because of their traditionally low frequency and high severity nature.

6.1.5 Pre-PIPP Tort Claims

As at July 31, 2003, there were 76 tort claims still unresolved. MPI confirmed that a provision of $9.1 million for these outstanding claims was adequate. MPI's update indicated that the number of unresolved claims had decreased to 63 by the end of September 2003.

6.2 Claims Expenses

Claims expenses represent the costs required to process and settle claims. Overall costs are allocated to claims expenses based on factors previously reviewed by the Board. For fiscal 2005

claims expenses are forecast to be $69.1 million compared to the revised fiscal 2004 forecast of $64.9 million. MPI attributes the 6.5% increase from fiscal 2004 to an estimated 3.0% CPI and other increases in data processing costs, compensation and special services such as auction fees, wellness initiatives and credit rating services.

6.2.1 Claims Cost Savings Initiatives

MPI's initiatives to control the severity and frequency of claims in respect of bodily injury and all perils occurrences have not changed since last year. Bodily injury cost savings initiatives continue to be focused on the needs of the accident victim to facilitate full and early recovery in a cost-effective manner. Quantification of actual cost savings in respect of bodily injury cost saving initiatives is not possible, given the general nature of the programs.

All perils cost savings initiatives consist of an increase in the use of after market and recycled parts, glass replacement program pricing reform, and a stereo claim initiative. MPI confirmed that during the 2002 calendar year a savings of $8.8 million was realized through the use of after market parts. For fiscal 2003, $9.9 million was saved by the use of recycled parts. Similar or somewhat greater savings are anticipated for fiscal 2004 and fiscal 2005. Glass replacement costs totalled $8.4 million in 2002 and $4.5 million for 2003. Similarly, stereo claims were $3.5 million in fiscal 1997 and decreased to $1.6 million in fiscal 2003.

6.2.2 Auto-theft Initiatives

In response to Order 203/02, MPI filed a document summarizing the existing auto-theft programs and highlighting the initiatives planned for the future. The report identified three main core activities on which MPI anticipates to focus its efforts. These activities consist of providing insurance incentives for installing anti-theft devices, supporting prosecution and enforcement efforts and developing marketing strategies to raise public awareness of the costs and issues associated with auto theft.

6.3 Operating Expenses

Operating expenses consist mainly of employee compensation, data processing, telecommunications, amortization, building expenses, and supplies for staff not directly handling customers' claims. Operating expenses in fiscal 2004 are forecast to be $36.7 million and are projected to increase 8.2% to $39.7 million in fiscal 2005.

Compensation is the most significant operating expense and comprises 55% of Basic's total projected operating expenses for fiscal 2005. Compensation has increased by 20.6% from $18.0 million in fiscal 2001 to $21.7 million in fiscal 2005, which is attributable primarily to inflation, merit increases, and increasing staff levels. MPI has budgeted for an increase in full time equivalent ("FTE") positions from 1,331.4 at March 1, 2003 to 1,368.6 at March 1, 2004. This is an increase of 37.2 FTE positions, of which 20 are in Claims Operations.

6.4 Information Technology ("IT")

MPI intends to undertake significant IT upgrades in the near future. During fiscal 2003, MPI approved a Program Charter for the Technical Change Management Program to manage the activities migrating from Sybase/PowerBuilder to a Microsoft Application. The need to migrate from Sybase/Powerbuilder to a Microsoft Application is the result of several factors including Sybase's continuing decline in market share in a mature marketplace dominated by three large players. In addition, Lawson Financials Corporation, the supplier of MPI's financial systems, announced that within two to three years they will no longer support Sybase.

Included in MPI's capital expenditure forecast for fiscal 2005 is an $8 million provision for future projects such as the migration to a Microsoft Application and a $3.5 million provision for data processing equipment related to computers, upgrades, servers, and other hardware. Further studies are being conducted to determine the cost of this project. The initial high level estimate

for external costs is approximately $43.9 million and does not include costs for internal staff, training, change management, and third party oversight.

6.5 Road Safety

Last year, in response to Order 179/01, MPI filed a report prepared by Manifest Communications Inc. ("Manifest") that provided an assessment of MPI's road safety program. Order 203/02 directed MPI to circulate the report to all stakeholders, including provincial agencies involved in vehicle or highway safety. MPI was further directed to respond to the report, including the concerns of the stakeholders.

After circulating the report to shareholders and receiving comments, MPI concluded there was a measure of benefit derived from the report and that most of the recommendations in the report will be implemented. MPI further noted it remains committed to its role as one participant among many active stakeholders in road safety. MPI intends to continue as the primary provider of road safety awareness and education and will focus on those activities.

Mothers Against Drunk Driving noted the need to draw the stakeholders together to form a working group that could develop recommendations and assist in implementing change. CAA supported MPI's educational initiatives but noted these were compromised by a lack of enforcement and engineering. CAA urged all to demand that government provide funding and follow-up for these aspects to compliment MPI's educational programs.

The Injury Protection Centre of Children's Hospital stressed the need for more leadership and co-ordination in road safety since there was a duplication of efforts and services. The Centre was particularly concerned with the report's evaluation methods, noting the report, prepared by a social marketing firm, lacked vigour and scientific credibility. Furthermore, the Centre noted the report recommended MPI move away from enforcement, engineering and research and instead

concentrate on education and social marketing – contrary to what current research evidence recommends.

The provincial Department of Transportation provided lengthy comments indicating the magnitude of the inaccuracies in the report, stating that the assessment of road safety is based on misrepresentation or misinterpretation of the statistics and the environment in which the stakeholders operate. A number of recommendations followed including that the Department of Transportation assume a greater leadership role in the co-ordination of Manitoba's road safety, that MPI continue its public awareness and education initiatives, and that evaluation of safety awareness initiatives be based on qualitative measurement to determine their effectiveness.

7.0 Net Income

7.1 Vehicle Upgrade Factor

In projecting annual revenues, MPI includes a vehicle upgrade factor ("upgrade factor"). The upgrade factor accounts for increased premium revenue due to the replacement of older vehicles in the fleet with newer vehicles, resulting in classification changes and vehicle drift. It also considers the impact on revenues of drift between standard and merit premiums. The projections in this year's application assume an upgrade factor of 3.5% for fiscal 2005 and beyond, compared to an actual of 4.1% for fiscal 2003 and an estimated 3.5% for fiscal 2004.

7.2 Volume Factor

MPI also considers increases in revenue that will result from an overall increase in the number of vehicles insured, referred to as the volume factor. The projections in this year's application assume a volume factor of 1.0% for fiscal 2005 and beyond, compared with an actual of 1.9% for fiscal 2003 and an estimated 1.0% for fiscal 2004.

7.3 Forecasted Net Income

MPI's actual net income has varied considerably from its revised forecast since fiscal 1999, as illustrated in the following table:

Total Net Income (Loss) for Fiscal Years Ending February 28 ($ millions)

	1999	2000	2001	2002	2003	2004	2005
Approved forecast	18.9	19.3	11.7	28.7	2.2	9.8	(13.8)
Revised forecast	17.5	18.4	43.7	(14.3)	10.2	(1.3)	
Actual	41.9	40.5	38.1	(11.7)	(30.1)	-	
Actual greater (less) than revised forecast	24.4	22.1	(5.6)	2.6	(40.3)	-	

MPI recorded a net loss of $30.1 million for fiscal 2003, compared to a forecast net income of $10.2 million. Actual investment income was $18.1 million lower than the revised forecast. The difference was due to lower than expected earnings from the equity portfolio. Claims incurred and claims and road safety expenses were $21.3 million higher than the revised forecast. The difference was primarily due to higher than expected frequency and severity of claims experience.

MPI is forecasting a net loss of $1.3 million for fiscal 2004, which represents a decrease of $8.4 million from its forecast reviewed by the Board in last year's GRA. MPI attributed the change to a $3.1 million decrease in premiums earned due to the carryover effect of a lower than estimated upgrade factor in fiscal 2003 from 5.5% to 4.1%. This has the effect of reducing the base premiums used to calculate the fiscal 2004 premiums. Claims costs, claims and road safety expenses are forecast to be $542.6 million in fiscal 2004, an increase of $4.1 million compared to last year's projection. The significant factors causing this change are increases in PIPP and collision claims costs. The main reason for the PIPP claims costs increase is due primarily to an increase in severity, while the increase in collision claims costs is due to increased frequency. Investment income is forecast to be $61.5 million. The decrease of $3.2 million from the previous projection is due to the continued volatility in equity markets.

An underwriting loss of $81.1 million and investment income of $67.3 million is forecast for fiscal 2005, resulting in a forecasted net loss of $13.8 million. Total earned revenues are projected to be $592.9 million compared to $559.2 million in the forecast for fiscal 2004. Forecasted net claims incurred are $512.2 million, an increase of $41.5 million from the fiscal 2004 forecast. The forecasted net loss of $13.8 million is based on an overall increase in revenue of 2.5%. If the actuarially indicated required rate increase of 4.3% had been requested, the forecasted net income for fiscal 2005 would be $3.7 million.

7.4 Actuarially Indicated Rates

MPI has requested a 2.5% increase in overall premium revenue even though the actuarial analysis indicates a 4.3% increase is required. MPI submitted that this course is reasonable and prudent, given it intends to smooth rates over a period of time greater than the year of the application. MPI stated that the actuarially required rates, based on its current analyses, are for increases of 1.2% for fiscal 2006 and 0.4% for fiscal 2007.

In order to achieve rate stability MPI requested overall premium revenues be increased by 2.5% for fiscal 2005, and that all else being equal, MPI would request an increase of 2.5% for each of fiscal 2006 and 2007. MPI contended its position as the monopoly provider of Basic Insurance in Manitoba allows it the flexibility to achieve rate smoothing in this manner. MPI conceded that if claims costs and expenses were higher or investment income less than forecast the rate requirement for the future years would be greater.

7.5 Fiscal 2004 Results – First Six Months

In a response to an undertaking, MPI filed an updated Statement of Operations for fiscal 2004 marked as MPI Exhibit #7, incorporating six months of actual results, and projecting net income to fiscal 2008, under two scenarios. The first scenario assumed moderate serious loss counts while the other assumed high serious loss counts. Actual results for the first six months indicated that, relative to fiscal 2003, claims and expenses had increased by $27.7 million, primarily because of a 27.9% increase in PIPP severity and 6% increase in physical damage claim frequency. The increase in claims costs was offset by a $21.6 million increase in total earned revenues due to a greater than anticipated number and value of vehicles insured. The result is that, after six months, the underwriting loss was $8.9 million, compared to $2.7 million in fiscal 2003.

Additionally, investment income had increased by approximately $13 million, and net income was $39.2 million compared to $26.1 million after six months last year. Despite these significant variances, MPI did not change the forecast for fiscal 2004 or fiscal 2005 indicating that significant variances can normally be expected, and to react to six month actual results would be premature, as the last six months results could also show significant variances, in either direction.

MPI indicated that in the moderate serious loss count scenario, the fiscal 2004 claims incurred would increase from the current forecast of $470.8 million to $494.1 million, and further increase under the high serious loss count scenario to $514.4 million. After making required adjustment for expenses and investment income, the net loss for fiscal 2004 would increase from the GRA forecast of $1.3 million to a net loss of $3.2 million in the moderate scenarios and a net loss of $23.7 million in the high scenario.

8.0 Rate Stabilization Reserve ("RSR")

8.1 Background

MPI is committed to ensuring the Basic Program remains financially self-sufficient and stable through maintenance of the RSR and to breaking even on operations over the long term. The purpose of the RSR is to protect motorists from large rate increases otherwise be necessary because of losses arising from non-recurring and unexpected events or factors.

A summary of the RSR balance for Basic insurance from fiscal 2002 to fiscal 2008 is as follows:

Basic Insurance Rate Stabilization Reserve ($ millions)

	Actual		Forecast	Projected	Outlook		
Fiscal Years Ending February 28 , 29	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**
RSR, opening balance	143.0	50.5	35.4	38.1	25.9	35.0	49.9
Net income (loss)	(11.7)	(30.1)	(1.3)	(13.8)	1.1	5.9	2.6
Surplus dividend	(80.8)	.5	-				
Transfer from SRE	-	14.5	4.0	1.6	4.0	4.0	5.0
Transfer from Extension	-				4.0	5.0	6.0
Total RSR	50.5	35.4	38.1	25.9	35.0	49.9	63.6

As at February 28, 2003, the RSR was $35.4 million. MPI stated that during fiscal 2003, there were unique, unexpected and non-recurring events that drove the RSR balance below $40 million. Those events included higher than expected net claims incurred and actual investment income lower than forecast.

For fiscal 2004, MPI is forecasting a net loss of $1.3 million. With the net loss and an anticipated transfer of $4 million from Special Risk Extension ("SRE") line of business, the RSR is now forecasted to be $38.1 million as at February 29, 2004. The RSR is projected to be $25.9 million at the end of fiscal 2005, which is well below the Board's minimum target of $50 million for rate-setting purposes.

8.2 RSR Transfer From Other Division

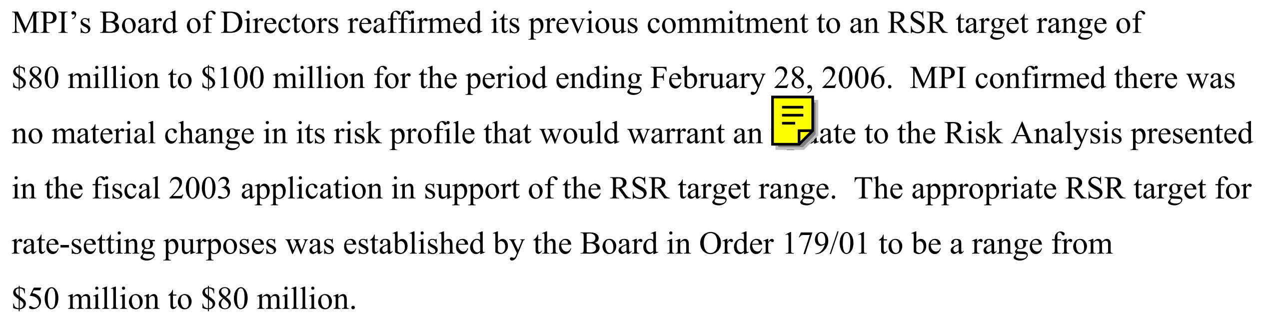
Annually, MPI will transfer to the Basic RSR, retained earnings in excess of approved target levels for the SRE and the Extension lines of business. The approved target levels for the period ended February 28, 2005, established by MPI's Board of Directors, are:

Line of Business	Target Level
SRE	$33.0 million
Extension	39.0 million

MPI noted that due to their competitive nature, the retained earnings target levels for SRE and Extension are reviewed annually.

MPI transferred $14.5 million on March 1, 2002 and $4.0 million on March 1, 2003 from SRE retained earnings to the Basic RSR. MPI is forecasting to transfer $1.6 million for fiscal 2005 as opposed to $3 million projected a year ago. In fiscal 2006, MPI is projecting to transfer $8 million ($4 million from SRE and $4 million from Extension), $9 million in fiscal 2007 ($4 million from SRE and $5 million from Extension), and $11 million in fiscal 2008 ($5 million from SRE and $6 million from Extension) to the Basic RSR. MPI indicated that it was budgeting operations to meet the transfer targets from SRE and Extension. For competitive reasons, MPI provided limited information supporting the projections for Extension and SRE to the Board.

8.3 RSR Target



MPI's Board of Directors reaffirmed its previous commitment to an RSR target range of $80 million to $100 million for the period ending February 28, 2006. MPI confirmed there was no material change in its risk profile that would warrant an update to the Risk Analysis presented in the fiscal 2003 application in support of the RSR target range. The appropriate RSR target for rate-setting purposes was established by the Board in Order 179/01 to be a range from $50 million to $80 million.

MPI filed a Dynamic Capital Adequacy Test ("DCAT") for information purposes. The DCAT is required by insurers regulated by the Office of Superintendent of Financial Institutions ("OSFI"). The DCAT reviews the financial condition of insurance companies by analyzing and projecting the trends of a company's financial condition. The DCAT examines the past experience, the current financial and operating position, and the intended business plan under a variety of future adverse scenarios. This provides MPI with information on courses of events that may lead to capital depletion and the relative effectiveness of alternate corrective actions. MPI requested its external actuary prepare the DCAT and recommend an appropriate Basic RSR target range.

The DCAT recommended an RSR range of 11% to 16% of gross claims liability which translated into a range of $99 million to $144 million at February 28, 2003. The report further recommended that the RSR target range be determined based as a percentage of the unpaid claims liability rather than a fixed dollar range.

MPI acknowledged that it was not subject to OSFI regulation. The DCAT is a recognized method of measuring risk in the insurance industry. MPI further indicated that it plans to replace the Risk Analysis previously prepared with the DCAT for setting the appropriate level of the RSR. The results of the DCAT will be reviewed during the upcoming year and may form part of the application at the next GRA.

8.4 RSR Rebuilding Plan

MPI intends to rebuild the RSR by transferring from the competitive product lines retained earnings in excess of approved target levels to the RSR. Under the current plan, MPI expects to achieve the Board's minimum RSR target level by fiscal 2007. MPI would consider introducing dedicated RSR surcharges if sufficient transfers are not available from the competitive lines of business or there is a continued decline in the RSR making rebuilding less likely within five years.

9.0 Rate Design

9.1 Actuarial Methodology

This Application reflects an actuarial methodology for projecting the required rate levels that is substantially unchanged from that used in previous applications. This involves combining claims incurred estimates arising from each of the Financial, Exponential, and Linear Methods, with appropriately consistent estimated provisions for claims expenses, operating expenses, commissions, premium taxes, and the cost of reinsurance and fleet rebates, offset in part by estimated revenue contributions arising from drivers' premiums, service fees and investment income.

9.1.1 Allocation of Operating Costs

In this Application, MPI continued the process started two years ago of moving towards eliminating the allocation of operating costs to the Trailer and Off Road Vehicle major classifications. An additional 25% of operating costs has been reallocated to the other major classifications, bringing the total amount reallocated to 75%. The phase-in of the reallocation is expected to be completed next year.

9.2 Major Classification, Insurance Use and Rating Territory

MPI continues to classify vehicle risk by considering insurance use, rating territories, and rate groups. MPI has proposed making a number of changes to insurance uses as follows:

- Altering the definition for Disabled Persons/Private/Business Bus;
- Altering the definition of Wheelchair Livery/Bus;
- Combining courtesy vehicles with U-Drive vehicles;
- Separating farm trucks from fishing trucks;
- Separating passenger vehicles and trucks in the common carrier within Manitoba category; and
- Altering the definition of motor scooters.

Each of these changes reflects the ongoing changes to vehicle risk associated with its use or is a clarification of the definition.

9.3 Rate Groups

9.3.1 Canadian Loss Experience Automobile Rating ("CLEAR")

MPI continues with its adaptation of the insurance industry Canadian Loss Experience Automobile Rating ("CLEAR") system for passenger vehicles and light trucks. The CLEAR system uses actual loss experience data from across Canada to determine relative loss cost indices for specific makes, models, and model years of specific vehicles. This analysis considers repair costs, comprehensive claims, and injuries associated with different types of vehicles. This data is used to establish homogeneous groupings of these vehicles and rate group relativities for these groupings, on which vehicle premiums are based.

9.3.2 Rate Group Adjustments for Passenger Vehicles and Light Trucks

In this GRA, MPI continues to implement two types of rate group adjustments undertaken for passenger vehicles and light trucks:

- Revision of the relationship between the rate and rate group to be more consistent across rate groups; and
- Application of annual CLEAR rate group update adjustments, as provided by the Insurance Bureau of Canada.

9.3.3 Rate Group Vehicle Description Table Refinement Initiative

To ensure the ongoing integrity of MPI's data and of the vehicle information displayed on documents and in the system, an analysis was conducted of light trucks to determine the extent to which there were variances between the vehicle description implied by the Vehicle Information Number ("VIN") through decoding software and the vehicle description stated by the customer upon initial registration. In approximately 19,000 cases the descriptions were at odds with the

VIN and sometimes led to assignment to incorrect rate groups. In all cases MPI is now correcting the misstated descriptions in this application. MPI will invoke this analysis for the private passenger vehicles for next year, but does not expect to encounter as many misstatements.

9.4 Premium Impact

The Application seeks approval of motor vehicle premiums which, on an overall basis, would result in no change in average vehicle premium rates. The following table indicates the difference between the experience rate requirement indicators based upon the financial forecast method and the requested revenue adjustments:

Major Use	Actuarially Indicated Rate Changes (4.3%)	Experience Based Rate Requirements (2.5%)	Revenue Adjustments Requested (2.5%)
Private Passenger	2.7	0.9	2.9
Commercial	4.5	2.7	5.7
Public	2.7	1.0	1.3
Motorcycles	29.7	27.4	19.9
Trailers	-34.6	-35.7	-32.4
Off Road Vehicles	-30.1	-31.3	-30.6
Overall	4.3	2.5	2.5

The process used to transition from the experience-based rate requirements to the requested revenue adjustments is as follows:

Step 1 - Combine and rebalance the Major Classification indicators with the updated insurance use and territory differentials;

Step 2 - Iteratively apply the rules for capping the experience adjustments at +/-15%, again subject to rebalancing for each iteration;

Step 3 - Final testing and rebalancing in MPI's rate model to measure the premium impact on a static fleet of vehicles.

Due to this iterative capping and rebalancing process, the determination of the proposed rate for each insurance use and territory rating cell can have a potential impact on all other rating cells. Accordingly, the impact of the capping process can vary significantly between Major Classifications, depending upon the direction and extent to which individual insurance use and territory rating cells are directly affected by the cap.

In Order 203/02 MPI was urged to improve the transparency of its rate making model. MPI responded by outlining in table form the transition of the various steps by major classification, insurance use, and territory. The table showed the average rate, the change from the original rate model, and the total premium of each in a seven-step process.

The overall impact of rate adjustments on the total vehicle population as applied for by MPI is as follows:

- 36% of vehicles will receive a rate decrease, with most receiving a rate decrease of less than $50;
- 1% of vehicles will remain unchanged; and
- 63% of vehicles will receive a rate increase, with most receiving an increase of less than $50.

9.5 Motorcycles

All Major Classes including motorcycles are designated by Provincial regulation. Motorcycles are assigned to ten rate groups based on owner declared value. Individual premiums within each class are based on engine size. After an analysis of the relationship of rates and rate groups, MPI has developed a new target line for motorcycles which it proposes to begin implementing this year. In general, lower rate groups are grossly under-rated and high rate groups are now properly rated. MPI has decided not to apply any experience-based adjustments to the Motorcycle Class in fiscal 2005, opting instead to embed rate increases into the rate line adjustment, according to

actuarially indicated requirements. Proposed individual rate group increases have been capped at 30%.

The following table illustrates the current, proposed, and target rate relativities as well as current and average rate levels per rate group:

Rate Group	Present Rate Relativity 2004	Proposed Rate Relativity 2005	Target Rate Relativity	Current Average Rate ($)	Average Target Rate ($)	Percent Increase After Capping (%)
0	.3394	.4616	.7138	428	1,029	30.01
1	.4317	.5784	.7456	522	1,075	27.93
2	.4829	.6374	.7774	616	1,121	26.00
3	.5524	.7181	.8092	707	1,167	23.93
4	.6298	.8062	.8410	867	1,213	22.00
5	.6913	.8728	.8728	1,005	1,259	20.00
6	.7745	.9046	.9046	1,028	1,305	17.08
7	.8747	.9364	.9364	1,179	1,350	7.20
8	.9624	.9682	.9682	1,288	1,396	.68
9	1.0	1.0	1.0	1,797	1,442	.0

Based on current forecasts, this approach will establish motorcycle rates that are sufficient at and above rate group five within two years, with lower rate groups taking as much as four to five years. As a result of this applied for change, motorcycle rates will increase, on average, by 20%. However, the individual rate group increases will range from 0 to 30%. Of the 8,842 motorcycles, rates for 578 will remain unchanged, rates for 1,463 will increase by less than $100, rates for 4,508 will increase between $100 and $200, and rates for 2,293 will increase by more than $200.

Witnesses for MPI noted that personal injury claims comprise 80% of the claims costs for motorcycles, whereas for the vehicle population as a whole, approximately 43% of the costs are

personal injury claims. Since personal injury costs do not vary significantly with the value of the motorcycle, the lower rate group premiums are currently grossly inadequate. As an example, motorcycles in rate group 0 pay a rate of $428 but the required rate is $1,029.

MPI indicated it was seeking an overall 20% increase in revenue from the Motorcycle Class rather than the 15% cap usually requested in the recent past because it sought to balance the rate increase required with the dollar impact to its customers. Furthermore, MPI submitted that, at 15% increases, rates would never attain the levels required to match claims costs. Finally, MPI witnesses noted that other customers frequently receive increases in excess of 30%, depending on changes to rate groups and driver experience amongst other things.

MPI recently started tracking claims data by motorcycle body style. With two years experience, the following data, based on a two year average, indicates that claims frequency for sport bikes is four times as high as for the other remaining types of motorcycles:

	# of Units	Claims Incurred ($)	Pure Premium ($)	Frequency (%)	Severity ($)
Other	4,022	4,120,067	511.99	3.06	16,+748
Scooter	25	-	-	-	-
Sport	1,069	6,299,600	2,944.79	16.59	17,745
Touring	1,640	801,519	244.25	2.50	9,775

9.6 Loss Transfer

In Order 203/02, the Board directed MPI to review the matter of loss transfer and report its recommendations at the next GRA. MPI prepared a report outlining the rationale for the current system of assigning claims costs on a first party basis. MPI stated that its approach to assessing risk and assigning claims costs is inherently fair, non preferential and not unfairly discriminatory. Additionally, it treats all motorists and vehicles similarly and equitably using appropriate means of assessing the likelihood of claims cost frequency and severity. MPI further stated its approach to assessing risk and assigning claims cost is reasonable and ensures motorists have the greatest control on the amount they pay for automobile insurance by the choices they make. This approach also reduces the time and cost of resolving liability, yielding high standards of customer service.

The following table shows the credibility weighted rate indications by major class with and without loss transfer being applied across the entire vehicle population:

Major Class	Indicated Rate Changes Before Loss Transfer (%)	Indicated Rate Changes After Loss Transfer (%)
Private Passenger	2.7	2.1
Commercial	4.5	10.0
Public	2.7	10.1
Motorcycles	29.7	23.6
Trailers	-34.6	-29.9
Off Road Vehicles	-30.1	-20.9
Overall	4.3	4.3

MPI noted there would be even greater rate dislocation within the Major Classes.

MPI explained that the difference of 6.1% that the Motorcycle Class would experience is significantly lower than previous studies had indicated (45% indicated rate increase vs. 10% with loss transfer in 1994 and 58% indicated rate increase vs. 38% with loss transfer in 1998). This is because as PIPP data matures, motorcycles have experienced a substantial number of serious losses which exceeded the benefits previously available under the tort system. According to MPI, the vast majority of motorcycle serious losses occur in single vehicle accidents where loss transfer would not be applicable. Of the $25.9 million in motorcycle serious losses, less than $1.6 million were generated in multi-vehicle collisions where the other vehicle was at fault, and thereby subject to loss transfer. Of the $29.1 million in non-serious motorcycle losses, $8.9 million are multi-vehicle collisions where the other vehicle was at fault. Therefore, out of $55 million in motorcycle losses, $10.5 million would be subject to loss transfer. Furthermore, the credibility weighted required rate as proposed for fiscal 2005 is $1,001, but with loss transfer this is decreased by $30 to $971. MPI stated in the long run the financial impact of loss transfer would not be significant, and based on the rate making principles adhered to by MPI, there should be little or no cross-subsidization. According to MPI, each major class should be responsible for the benefits paid to that class; therefore loss transfer would not be an appropriate mechanism.

9.7 Fleet Rebate/Surcharge Program

MPI offers a fleet rebate/surcharge program to owners who have ten or more vehicles and meet certain other minimum registration requirements. Vehicles excluded from the fleet program are taxis, liveries, motorcycles, mopeds, mobility vehicles, trailers, ORVs, and vehicles with PIPP coverage only. Fleet rebates/surcharges are determined based on the loss experience of a particular fleet, and are calculated based on the fleet's responsibility for an accident. Rebates/surcharges are based on a retrospective basis, using prior year's loss experience of a fleet. The fleet rebate scale ranges from 1% (for a 69% loss ratio) to 25% (for loss ratios of 45%

or less). Fleet surcharge scales, on the other hand, range from 1% (for a loss ratio of 80%) to 50% (for loss ratios of 129% or greater). MPI submits that this program is intended to encourage fleet owners to minimize claims cost in a manner similar to the merit/demerit system that encourages safe operation of vehicles by individual drivers.

In response to a directive in Order 203/02, MPI canvassed fleet owners to assess the degree of satisfaction with the current program. Based on responses to this survey, MPI concluded that the majority of fleet owners were satisfied. Consequently MPI has proposed no changes to the existing program.

10.0 Intervenor Positions

CAA

CAA expressed some confusion with the current GRA, since rates that are actuarially indicated are not being requested by MPI. CAA stated that it did not make sense to budget for a loss and delay a required rate increase. In CAA's view, this is not proper rate making.

CAA stated rates should be based on actuarial indicators as any other rates are not prudent for the motorists in the long term. The major concern is the ability to properly predict what may happen in the future, especially with investment returns.

CAA referred to the Crown Corporation Council's recent report which stated:

> "Council believes budgeting for losses is not a sound business practice. We believe filing a 04/05 General Rate Application for basic Autopac premiums that results in a planned loss heightens the risk that unfavourable financial results may necessitate larger premium requirements from ratepayers in the future."

CAA stated that the RSR is to be used for unexpected and non-recurring events and that the current draw down from investment income does not meet the definition for unexpected and non-recurring events. CAA submitted that the RSR is being used to cover all budget variances, which is only appropriate as long as the RSR is replenished.

CAA suggested that the Extension insurance is not truly competitive because it is assisted by MPI's computer system which is funded by the Basic Program. The system facilitates writing Extension insurance coverage, while competitors require forms to be filled out to issue a policy. CAA further noted that approximately 80% of Manitoba motorists purchase MPI Extension insurance, which provides some justification for the notion that the GRA process should encompass that line of business in addition to Basic insurance.

CAA stated that MPI's road safety program is satisfactory and suggested that MPI ought to continue with its initiatives.

CAC/MSOS

CAC/MSOS stated that it could not endorse MPI's request for a 2.5 % increase but it did concur with MPI that the proper response to a bad year's experience should be dampened given that, even with the adverse experience, MPI is financially strong.

CAC/MSOS requested the Board send a strong signal to MPI that the current regulatory model principles should be adhered to in meeting budgetary demands.

CAC/MSOS reinforced its support for the regulatory model that reflects a rating approach based upon actuarial principles and cost causality, promotes fairness and equity, and sets rates to break even over the long term. Such a model mitigates the need for sharp increases because rates are more responsive to changes in claims patterns and reflect a complete enumeration of all expected costs. CAC/MSOS stated that the MPI legislative model lies at the heart of MPI's strengths. Because MPI is a monopoly with the objective of providing a compulsory no-fault insurance scheme at cost, it should have lower average costs and rates than private insurers.

CAC/MSOS further stated deferring rate increases in a given year to achieve potential rate stability undermines fairness, efficiency and introduces intergenerational inequity. CAC/MSOS suggested that the way to create rate instability is to charge too much or too little. CAC/MSOS stated it could not accept MPI budgeting for a deficit of $13.8 million.

CAC/MSOS stated that the RSR was implemented to address one-time unexpected costs, thereby dampening volatility of rates. The RSR is not to mitigate actuarially indicated rates or to support deliberate budgeted deficits. It is a tool to mitigate unanticipated operating results.

CAC/MSOS further stated the RSR rebuilding plan contemplated it would be rebuilt through a planned measured response when the balance fell below target. CAC/MSOS questioned MPI's RSR rebuilding plan, which relies on transfers from Extension and SRE, noting that beyond fiscal 2005, projected transfers from Extension and SRE are substantial. CAC/MSOS submitted that little weight should be given to the reliability of the projections, which have not been tested.

CAC/MSOS questioned whether MPI's current costs and expenditures are prudent and reasonable, noting that MPI's 3% inflation estimate is overstated. CAC/MSOS cited recent comments by the Governor of the Bank of Canada which indicated that the trend of inflation would remain below the 2% target range. CAC/MSOS also noted that MPI's forecast is out of step with the Province's forecasts that projects inflation at 2.2% in 2003 and 1.7% in 2004.

CAC/MSOS expressed concern with the growth in the number of claims employees from 660 in fiscal 2000 to 754 projected for fiscal 2005, an increase of 94 employees since the implementation of the Claims Administration Reporting System, which streamlined the claims service. CAC/MSOS stated in light of tight financial times and the rate increases being sought, MPI ought to reallocate staff internally to meet service requirements rather than increasing the number of claims staff. CAC/MSOS stated that MPI should demonstrate it had done everything within its power to control expenditures.

CAC/MSOS recommended an overall premium revenue increase of 3.5% using a CPI of 2% be allowed. Alternatively, if the Board finds that the CPI assumptions are excessive and that staffing for claims positions is either unnecessary or could be found internally, CAC/MSOS recommend the Board impose a rate increase of 3%.

CAC/MSOS stated MPI had failed to achieve its road safety target with respect to occupant restraint as Manitoba is below the national average. CAC/MSOS questioned whether the current

level of road safety expenditure is properly focused given the results related to occupant restraint.

CAC/MSOS noted the significant increase in claims costs over the past decade, since the implementation of PIPP. CAC/MSOS requested MPI undertake a review of the program including a comparison of the PIPP experience in other jurisdictions such as Quebec.

CAC/MSOS did not endorse the proposed changes by MCTRA with respect to allocation of claims expenses.

CMMG

CMMG submitted that the large year over year rate increases for motorcycles is due to the rate models employed by MPI being inaccurate, arbitrary and deficient. CMMG suggested that the rate model uses a credibility weighting that is far too high and lacks statistical tests. CMMG noted that the single largest factor driving the larger motorcycle increases is the credibility weighting used by MPI. CMMG further noted alternative credibility weighting approaches are not employed or tested. CMMG noted alternative estimates of credibility suggest a much lower percentage than the 54.9% used in the model and use of an alternative would have a large impact on the premium requirement.

CMMG questioned the validity of the loss development factor used by MPI, a key component in the determination of rates. CMMG stated MPI has not filed any evidence that the loss development is stable or appropriately applied at the major class level. CMMG noted that instability in loss development will lead to fluctuating rates. An incorrect loss will develop for a small class such as motorcycles, and adversely affect the overall rate requirement for motorcycles, as a large proportion of motorcycle claims costs are injury costs. Without statistical testing, CMMG stated it is not possible to determine the correctness of these key factors and whether motorcycle rates are accurate.

CMMG disagreed with MPI's proposal for rate line adjustments, noting that no credibility weighting was applied in the adjustment formula; neither were rate line offset adjustments being applied on a revenue neutral basis, as is the case for passenger vehicles and light trucks.

CMMG further stated in setting the rate group line differentials, there was a lack of statistical diagnostics to test whether each variable or the relationship between the variables is correct, and thus it was impossible to determine if the rate line adjustment for motorcycles is statistically correct. Therefore, CMMG requested the Board disallow the rate line adjustments proposed by MPI. CMMG further noted that denial of the increase would not have an undesirable overall financial effect on MPI, since it would result in an approximate revenue decrease of $1.2 million.

CMMG requested the Board implement a loss transfer model, noting that if it were to do so, the rate required for motorcycles and private passenger would decline while commercial and public vehicle rates would increase. CMMG further noted that in provinces with a tort system, claim costs are assigned to responsible parties and are therefore correctly reflected in the rates.

CMMG recommended the Board order MPI implement motorcycle rates such that rate groups be capped at 10%, decreasing to 2% for rate group 8. This would yield a 6.3% overall increase in motorcycle premium revenue.

MCTRA

MCTRA contended that contrary to the Board's direction in Order 208/02, MPI failed to initiate meetings with MCTRA, a significant stakeholder, to discuss issues such as fleet rebates and surcharges on a retrospective versus prospective basis, loss ratio determinations and other matters related to U-Drive vehicles. MCTRA objected to the fact that it was not consulted on MPI's fleet program survey nor was it given an opportunity to express its views with respect to the use of a survey or its objectives. MCTRA suggested that five of the six largest U-Drive fleet owners were not included in the survey.

MCTRA also contends that MPI's survey was neither an acceptable response nor a substitute for focus group meetings which would have allowed for a delineation of issues, the consequences of proposed changes and a much fuller understanding of the strengths and shortcomings of the existing fleet program.

As it did last year, MCTRA requested that the fleet rebate system be based on a prospective basis. This would require the recognition of the rebate upon renewal, based on fleet owners' past year's claims experience, rather than under the current retrospective system where rebates are paid at the end of the year. MCTRA stated that there is no justification for treating fleet operators differently than owners of private passenger vehicles who have their driving experience reflected in premiums on a prospective basis. MCTRA further stated, that since the fleet program is heavily rebate driven, it is inequitable to require a fleet owner to initially pay higher premiums only to receive a rebate fourteen months later without any accrued interest, in addition to requiring fleet owners to pay a 5% brokers commission on the higher premium.

MCTRA requested the Board order MPI conduct the review MCTRA had expected would be done last year and to grant immediate relief from the additional costs MCTRA suggested were being charged to fleet owners. MCTRA maintained that the current fleet rebate system should account for interest on the amount of the premium that would not have been paid under a prospective system, the 5% brokers commission and the 3% premium tax payable to the provincial government.

In its view MPI did not comply with the Board direction in Order 203/02 in that it did not provide a report which reviewed alternatives for the allocation of claims expenses. This remains a major issue for MCTRA, particularly since MPI indicated that claims expenses are primarily fixed in nature. MCTRA urged the Board to direct MPI to again undertake the analysis and to prepare the report that was requested in Order 203/02. MCTRA also requested it be afforded an opportunity to provide input into that process.

MCTRA requested the Board to direct MPI to conduct an investigation with respect to the impact of duplicate insurance coverage where an owner's vehicle is in a body shop or maintenance facility and a U-Drive vehicle is being used as a replacement and report to the Board recommendations at the next GRA. MCTRA further requested that it be provided with an opportunity for input into that process.

MCTRA requested the Board to reconsider its position in Order 203/02 relative to transfers of retained earnings from SRE and Extension lines to Basic and requested MPI account for the transfers as income earned by the Basic Program. MCTRA stated the request is made as a result of the financial presentation of the transfers from SRE to Basic in the Audited Universal Compulsory Automobile Insurance Annual Report for the fiscal year ended February 28, 2003 (Basic Audited Financial Statement) which is prepared on the basis of generally accepted accounting principles ("GAAP"). MCTRA's witness contended that the $14.5 million allocation to Basic from SRE in fiscal 2003 is income and is of the same character as the investment income in determining the net income or loss from operations.

MCTRA questioned the reliability of MPI's calculation of average operating expenses, claims expenses, and regulatory appeal expenses, which were determined as an average of fiscal 2005 and fiscal 2006, and are not based on forecasts. MCTRA noted that fiscal 2005 financial information is based on projections and fiscal 2006 is based on outlooks and stated the fiscal 2005 and fiscal 2006 financial information should be prepared on a forecast basis rather than based on a projected or outlook basis.

MCTRA again requested the Board order MPI to significantly improve transparency of the transition from the indicated to the proposed rates by major classification.

11.0 Presenters

Mr. Bryan Robertson stated that in response to the high percentage of single vehicle motorcycle accidents, the government of Manitoba should provide mandatory driver education programs. With respect to impaired driving, Mr. Robertson stated that some insurance companies offer lower insurance rates for individuals who do not drink alcohol. He also stated that the punishment for drinking and driving should be more severe to deter individuals.

Mr. Robertson also challenged the fact that certain insurance coverage that used to be optional for motorcyclists is mandatory in Manitoba. He questioned whether insurance rates would be lower if certain coverage was optional. Mr. Robertson is of the opinion that the coverage that MPI is providing motorcyclists and the related cost should be reassessed.

Mr. Gerald H. Smith and **Mrs. Marie Smith** detailed various unresolved insurance claims related to their motor home. They also referred to the numerous problems their son experienced with respect to treatment for his physical injuries sustained in a motor vehicle accident. They stated that repairs to their motor home were done poorly and their son received insufficient treatment for his physical injuries. Further, they expressed the opinion that competition in automobile insurance would improve the level of customer service.

Mr. Robert Haegeman provided examples of the premiums that several of his co-workers, friends and family are paying to insure their motorcycles. He stressed that the proposed increases are causing these individuals to seriously rethink driving a motorcycle as insurance is becoming too expensive. Mr. Haegeman stated that MPI should reconsider the introduction of loss transfer since rate increases over the last ten years have averaged 15%, and the requested rate increases this year, are unreasonable. Mr. Haegeman provided a summary of loss transfer utilization in other jurisdictions. He also encouraged increased education and training programs

and other safety initiatives to help reduce the high level of personal injury costs associated with motorcycles.

Mr. Dale White stated that he is very concerned that MPI is not taking steps to reduce the large number of uninsured vehicles in the province. He was of the view that uninsured vehicles represent a significant revenue loss for MPI. Mr. White outlined various data sources that MPI has available to track uninsured drivers and he outlined several actions that MPI should take to reduce the number of uninsured motorists in Manitoba.

Mr. Denis Ferland expressed the opinion that he feels that the methodology used to set motorcycle premiums is against the *Charter of Rights and Freedoms*. Mr. Ferland also stated that other companies should be allowed to sell automobile insurance in Manitoba so that customers have a choice of insurance companies.

Mr. Paul Abbey expressed his concern regarding $3,600 in accident surcharges he is required to pay this year because of motor vehicle accidents. He stated the surcharges were not fair and too expensive for a senior citizen like himself.

12.0 Board Findings

Presenters

The Board wishes to thank all presenters who took the time to make their views known.

The Board notes that some presenters used the public rate-hearing forum to express their concerns with their outstanding claims. While the Board understands the difficulties experienced by some accident victims, the Board's jurisdiction is limited to rate-setting decisions. The Board suggests these presenters avail themselves of other forums, both internal and external to MPI, which are designed to address the concerns of individual accident victims.

With reference to Mr. White's presentation, the Board notes that there may be instances, where motorists who have renewed their coverage have neglected to affix the renewal sticker to their licence plates. The Board also notes that MPI currently conducts parking lot audits during the summer aimed at preventing vehicle theft. In response to Mr. White's presentation, the Board recommends that MPI consider expanding the scope of the audits to ensure that renewal stickers are current.

Net Income

Although the Financial Forecast Model indicated a required fiscal 2005 premium revenue increase of 4.3%, MPI has applied for a 2.5% increase. In prior applications, MPI consistently requested increases that were determined by the Financial Forecast Method for the year of the application. MPI's rationale for the change in this approach is that it allows a greater degree of rate stability by imposing 2.5% premium increases for this year, in fiscal 2006 and in fiscal 2007 to smooth rates. MPI claims it is able to provide this stability because of its status as a monopoly insurance provider. The Board notes that the statistically driven and actuarially based rates for

the two years projected beyond fiscal 2005 indicates that required premium revenue increases will be 1.2% in fiscal 2006 and 0.4% in fiscal 2007.

The Board agrees that because MPI has a captive market, greater flexibility is available to MPI in most areas of its Basic insurance operations. The Board also considers rate stability to be one of the primary objectives of rate regulation. However, the Board does not believe that the 2.5% increase sought by MPI for fiscal 2005, with the anticipation of identical or similar increases over two years beyond fiscal 2005, is in the public interest.

The Board notes that MPI has assumed a 3.5% vehicle upgrade factor and a 1.0% volume growth factor for fiscal 2005, fiscal 2006 and fiscal 2007 in forecasting premium revenue. While the Board acknowledges that the actual vehicle upgrade factor has been greater than projected from 2000 to 2002, the actual result in 2003 was 4.1%, compared to an estimated 5.5%.

Volume growth has been greater than the 1% forecast being nearly 2% for each of fiscal 2002 and 2003. Given the current economic circumstances in Manitoba, the Board is concerned that both these factors may be ambitious for the forecast years, resulting in income projections that may be at the high end. The Board will, however, accept these factors for purposes of forecasting fiscal 2005 revenues.

The Board notes the uncertainties regarding forecasted premium revenue, investment income and claims costs.

Actual fiscal 2003 investment income of $44.1 million is $18.1 million less than forecast. The Board notes that this has a direct relationship on MPI's operating results, as investment income is utilized to offset underwriting losses. Volatility in investment income is further evidenced by the fact that investment income for fiscal 2004, forecast to be $61.5 million, was revised to $81.2 million based on six months of actual data. The Board is of the view that there is a greater

risk to MPI's Basic Program's net income than has been the case in the past because of the continued uncertainty and volatility of investment markets.

With respect to the impact of claims incurred on net income, the Board acknowledges that on an overall long-term basis, MPI's forecasts have proven for the most part to be within a range of reasonableness. The Board notes that the variance between the Financial Forecast of Claims Incurred and actual results were -0.6% in fiscal 1999, -3.4% in fiscal 2000, +0.2% in fiscal 2001, +10.5% in fiscal 2002, and +5.8% in fiscal 2003; the five-year average variance being 2.4%. The Board particularly notes that variances in claims incurred have been 10.5% higher in fiscal 2002 and 5.8% higher in fiscal 2003 than estimated. While the two-year window may not be sufficient to indicate any change in trends, the Board is concerned that there may be emerging factors that could adversely impact future claims incurred costs. The Board further notes that a 1% increase in claims incurred for fiscal 2005 could increase claims costs by over $5.0 million.

An added concern for the Board arises from the updated fiscal 2004 Statement of Operations filed as MPI Exhibit #7. Depending on the assumed frequency of serious loss counts, the potential is for a further adverse claims incurred development of between $23.3 million and $43.6 million. The Board acknowledges that the adverse development is offset, in part, by an increase in investment income. However, any adverse development would directly impact RSR levels, resulting in further depletion of the RSR.

The Board is mindful of the statement issued by the Crown Corporations Council report for the three months ended June 30, 2003 which stated:

> "Council believes budgeting for losses is not a sound business practice. We believe filing a 2004/05 General Rate Application for Basic Autopac premiums that results in a planned loss heightens the risk that unfavourable financial results may necessitate larger premium requirements from ratepayers in the future. The Basic Insurance Rate Stabilization Reserve ("RSR") is well below the Board approved target range. Instead of seeking dedicated revenue increases, excess

> earnings from MPI's competitive business as well as any future surpluses will be used to rebuild the RSR."

In previous Orders, the Board has stated that MPI should, at a minimum, budget for a break-even position for the year of the application. The Board agreed that a break-even position would not necessarily result in a zero net income given the uncertainty in forecasting costs and/or revenues. The Board considers the projected $13.8 million net loss for fiscal 2005 to exceed the limits of a break-even position.

The Board is aware that forecasts are generally prepared approximately twenty-one months in advance of the end of the fiscal period. Because of this lead time, actual results have, from time to time, varied significantly from estimates. The Board considers that projections further into the future may be less precise and, given recent claims experience, could understate net income for such periods. Smoothing rates by utilizing cost and revenue projections for an additional twenty-four month outlook period could, in the Board's view, result in variances contributing to greater rate instability.

All of the above factors lead the Board to conclude that, on balance, the requested 2.5% increase for fiscal 2005 is inadequate and does not represent a prudent course of action at this time.

Absent any other evidence, the Board would have required MPI to increase premium revenue by the actuarially indicated premium revenue increase of 4.3% for fiscal 2005. However, the Board is cognizant of the position submitted by CAC/MSOS that the CPI of 3.0% used by MPI when preparing the application is now excessive, given current economic forecasts by various parties.

The Board agrees that the CPI of 3.0% was appropriate when MPI prepared its application, however, given recent forecasts by the Governor of the Bank of Canada and various consensus forecasts, it is now, in the Board's view, overstated. The most current forecasts suggest that a 2.0% CPI inflation rate for 2004 is at the high end of the range, and could be as low as 1.5%.

While the Board is of the view that MPI should always strive to control expenses, it is satisfied that there is no compelling evidence before it to require a further reduction in forecast fiscal 2005 expenses at this time.

The Board is of the view that to approve the 2.5% applied for increase would unduly expose Manitoba motorists to the possibility of much larger increases in the future to cover what could prove to be ever escalating claims costs and eroding RSR levels. Assuming a CPI of 2%, the Board estimates that a premium revenue increase of approximately 3.7% would result in a near break-even net income position for fiscal 2005. The Board, therefore, considers that a 3.7% increase will more accurately reflect the principle of applying actuarially indicated rates. It is also the Board's view that a 3.7% overall premium revenue increase will afford MPI the best opportunity to achieve a break-even net income in fiscal 2005. Such an increase will prevent further deterioration of the current RSR level. The Board will therefore require MPI to recalculate the fiscal 2005 automobile premiums to reflect an overall premium revenue increase of 3.7%.

RSR

In Order 179/01, the Board established a range of $50 to $80 million as the appropriate target RSR range for rate-setting purposes based on its evaluation of MPI's Risk Analysis. The Board reaffirmed this RSR range in Order 203/02, noting then that the Board will adjust this target only if and when MPI justifies any increased Corporate risk profile. The Board further notes that witnesses from MPI stated at this proceeding that there has not been a material change in the risk profile of MPI, regardless of the adverse operating results experienced in fiscal 2003.

MPI requested its external actuary to prepare a DCAT to recommend an appropriate Basic RSR target range. While MPI's current RSR target range is $80 million to $100 million, the DCAT contains a recommendation that a range be established based on a percentage of outstanding

claims liabilities, and for fiscal 2004 this would be $99 million to $144 million. MPI filed this document for information only and did not propose any change to the current RSR level. The Board notes MPI's statement that the RSR target range will be a matter of discussion with MPI's Board of Directors, and if it is to be changed, it is likely that the DCAT analyses and recommendations will be the basis for a revised target. In that event the DCAT will be filed at the next GRA for scrutiny by all interested parties. The Board further notes MPI's indication that if a change in the RSR target range is to be proposed, the previous risk analysis conducted by MPI would likely be replaced by the DCAT.

The Board notes that the current balance of the RSR is well below the target range of $99 million to $144 million recommended in the DCAT. The Board further notes that as a result of the adverse operating results of a $30.1 million loss in fiscal 2003, the RSR is currently $35.4 million, well below the bottom end of the Board established range. With a budgeted net loss of $1.3 million for fiscal 2004 and a forecasted net loss of $13.8 million for fiscal 2005, the RSR is forecasted to be $25.9 million at February 28, 2005. The Board is concerned that, even if all assumptions used in this application prove to be correct, including 2.5% rate increases this year and in the next two years, the RSR level will continue to be below the Board's currently approved range for the next three years.

MPI's RSR rebuilding plan is predicated on transferring retained earnings from SRE and Extension which are in excess of approved targets. However, the Board has concerns that the transfers cannot be relied on for the RSR rebuilding plan, because they are based on projections and outlooks that have not been brought before the Board. As a result, the Board is not able to conduct any in-depth review of the reasonableness of forecast transfers of retained earnings from SRE and Extension to the Basic RSR. The Board appreciates the decision of the MPI Board respecting the transfers but cannot completely rely on the forecasts on which they are based.

MPI has indicated that the budgets presented are targets that MPI is striving to meet. Actual results may differ significantly from budget, similar to the experience in fiscal 2003 where actual claims incurred and investment income resulted in significant variances from forecast. MPI has indicated that these variances were due to non-recurring events. However the Board remains concerned that there is a risk that the experience is more than non-recurring, especially in light of the information filed during the hearing for the first six months of the current fiscal year which indicates an adverse claims experience compared to forecast. Accordingly the Board will direct MPI to file an RSR rebuilding plan with the Board if adverse claims experience further deteriorates the RSR.

Rate Design

As in previous applications, the Board has considered the various aspects of MPI's rate design and continues to be of the view that it produces fair and equitable rate relationships that are reasonably reflective of risk. The actuarial rate making methodology is substantially unchanged from that of previous applications.

The Board will approve MPI's application for experience based adjustments ranging from -15% to +15% based on rate adjustment rules and classification offsets subject to an overall premium revenue increase of 3.7%. Both of these are continuing rate design initiatives from previous years. Of course, the difference this year is that for motorcycles, no experience based adjustment is applicable, and the classification offsets are not revenue neutral for motorcycles.

As part of an ongoing review of the varying degrees of risk associated with the different purposes for which vehicles are used, MPI has proposed various changes to insurance uses and definitions for this application. The Board will approve the changes sought to each of the following:

- Altering the definition of Disabled Persons/Private Business Passenger Vehicle or Bus;
- Altering the definition of Wheelchair Livery Bus/or Passenger Vehicles;

- Combining Courtesy classifications with U-Drive vehicles;
- Separating Farm Trucks from Fishing Trucks;
- Separating passenger vehicles and trucks in the Common Carrier within Manitoba categories; and
- Altering the definition of motor scooter.

Each of these changes reflects the ongoing changes in risk associated with the use of the vehicle. The changes in definitions will enhance clarification and consistency, whereas the motor scooter definition change brings it in line with the changes that have occurred in the marketplace. Each of these is reasonable and therefore approved by the Board.

The Board continues to support MPI's adaptation of the CLEAR system for passenger vehicles and light trucks. The Board believes motor vehicle premiums are more accurately reflective of risk by annually applying the CLEAR rate group update adjustments and revising the relationship between the rate and rate group to be more consistent across the rate groups. The Board will approve all rate adjustments required to ensure the vehicles are in the rate group required by its vehicle identification number. As a result, the data integral to the CLEAR rating system and the rate making methodology will then be more accurate. The Board further recognizes that while this variance relates only to light trucks, MPI will continue the process next year for the passenger vehicle fleet. The Board also notes MPI will undertake annual reviews to ensure there are no large numbers of corrections required in the future.

The Board will approve the third phase of the implementation of the reallocation of operating expenses, which involves an additional 25% from Trailers and ORVs being allocated to Highway Traffic Act power units. The Board expects complete implementation in the next application year.

Loss Transfer

The Board appreciates the work undertaken by MPI to produce the report on loss transfer pursuant to Order 203/02, especially the calculations required to produce the indicated required rates by major class if loss transfer were adopted by MPI.

In examining the indicated rate changes, the Board reviewed the differences in the indicated rate change for some major classes before and after the implementation of loss transfer. This information shows significant rate dislocation for most motor vehicles at the major class level. The Board is concerned with the even greater rate dislocation that would occur below the major class level. Given the substantial rate changes that could result to some of the vehicle population if loss transfer were to be adopted, more compelling reasons must be advanced before the Board will order MPI to abandon the current system of assigning costs to the major class where those claims are incurred on a first-party basis.

The CLEAR system assesses risk on a first party basis and makes no attempt to assess the extent to which a particular vehicle may damage another vehicle if involved in multi-vehicle collisions. CLEAR rate group assignments are linked directly to the first party principle, since it describes the unique risk characteristics of each vehicle and not risk measured as the result of third party liability. Therefore, determining credible rate groups on an at-fault basis for loss transfer would not be possible. For MPI to adopt a complete at-fault assignment, it would require complete historical data by make, model and model year. Such data may be sparse and statistically unreliable. The Board agrees with MPI this is the single greatest impediment to introducing loss transfer. Hence, loss transfer could only be implemented at the territory and insurance use level, leaving the assignment of rate groups on a third party basis. This would be an incongruous situation in ratemaking.

The Board is of the view that loss transfer would not provide any additional incentive to drive more carefully. First, the merit discount program already targets drivers with poor driving

records who impose higher costs upon the system. Second, loss transfer can only be implemented on a territorial and insurance use level, not according to the vehicle make, model and model year. Third, with the element of randomness in the causation of accidents, it is only to a minimal extent that MPI could communicate individual responsibility or individual choice through vehicle premiums.

Additionally, the extreme dislocation by Major Class and even within the Major Class must be factored into the Board's decision to reject loss transfer. There must be compelling reasons to justify a 6.5% rate increase for the 43,000 commercial vehicles and a 6.3% decrease for the 8,000 motorcycles. As outlined in this section, such compelling principles are lacking in the Board's view.

With respect to motorcycles, the difference between the indicated rate changes required with and without loss transfer is 6.1%. This is a much smaller gap than shown in previous analyses, and the Board agrees this is attributable to the growth in PIPP claims, especially for the high incidence of serious losses for motorcycles.

For the foregoing reasons, the Board is not persuaded to adopt loss transfer as part of the ratemaking methodology.

Motorcycles

The magnitude of required motorcycle rate increases for the past decade has concerned the Board. Notwithstanding the approximately 15% annual increases assigned to motorcycles in the past years, the current motorcycle rates still remain well below the actuarially indicated rate.

While the Board is concerned with the effect increasing insurance premiums may have on the motorcycle industry in Manitoba and the decline of the motorcycle population, the Board cannot ignore the underlying data that requires continuing high insurance premiums. Motorcycles are

inherently risky due to their lack of protection for the motorcyclist and passenger; yet it is this element of freedom and openness which attracts many to ride motorcycles.

Like all Major Vehicle Classes, the Motorcycle Class is stipulated by Provincial regulation. As its own major class, the claims costs and expenses paid to or on behalf of members of that major class should be borne by those members, absent any form of loss transfer. To do any less is to have that major use cross-subsidized by the other major uses. This is what has occurred for more than the past decade. MPI, supported by the Board, is committed to halting this cross-subsidization of the motorcycle major use class by others. Any insurance scheme entails the sharing of risk by those with similar risk characteristics – in this case motorcyclists are grouped together as having similar risks. These risks are further refined according to the motorcycle's assignment to a rate group based on owner declared value. Engine displacement and claims experience are used to determine individual premiums within rate groups. A further refinement is that sport bikes are currently being assigned premiums that are 10% greater than the Motorcycle Class average.

For a relatively small vehicle population of approximately 8,000, the claims experience has been significant. The Board is concerned that the number of claims has increased from 278 in fiscal 1999 to 472 in fiscal 2003 while the motorcycle population remained constant, or decreased slightly during the same time. The Board notes that, coincident with the increase in frequency, the claims severity, although extremely variable, has also increased. Since 1999 the claims incurred Basic losses for the Motorcycle Class has been as follows:

Year	Claims Incurred ($ millions)
1999	$3.6
2000	3.1
2001	3.3
2002	7.2
2003	4.4

In fiscal 2002 a single claim of $3.4 million was recorded. In the current year claims will likely be at the high end due to several serious losses.

The introduction of PIPP resulted in more extensive benefits being available to injured parties on a first party basis. The Board notes MPI's contention that PIPP benefits in Manitoba are more enhanced than those provided in other Canadian jurisdictions, and therefore no meaningful comparison of Manitoba motorcycle rates can be made with motorcycle rates in other jurisdictions.

The actuarially indicated rate for fiscal 2005 is calculated using a credibility weighting of 54.9%. Prior to the consideration of credibility, the required rate increase is substantially higher (50.4% compared to 27.4% after credibility weighting). While CMMG challenged the calculation of the credibility weighting, suggesting it puts too much reliance on motorcycle experience, the Board has seen no evidence put forward to cause it to question or review MPI's calculation of credibility weighting. In fact, since the credibility weighting acts to temper the response to the motorcycle experience, any lowering of the motorcycle credibility would simply further prolong the achievement of a rate level for motorcycles that might be considered adequate to meet expected costs when viewed over the long term.

The Board will request more information on the elements and characteristics of risk associated with motorcycles, not only at the major use level, but also at the rate group and type level. The applied for new target rate line for motorcycles, with the inherent flattening of the differentials, is one step to allowing the Board to better understand the risk associated with different motorcycles. The Board urges MPI to gather more information on motorcycle risk, whether it be related to experience and training of riders, the type of motorcycle or any other information, in an effort to developing an improved categorization of motorcycle risk. Furthermore, MPI should investigate and determine if a form of graduated licencing and/or mandated training would be appropriate, and report back to the Board on both these matters.

The Board agrees with MPI's new target rate line for motorcycles for the following reasons:

- Data indicates lower rate groups are currently underrated while higher rate groups are rated adequately;
- Individual motorcycle rates will better reflect their risk;
- Motorcycle premiums will better match claims costs by rate group;
- Since bodily injury claims constitute 80% of motorcycle claims and do not vary significantly by rate group, there should not be a substantial difference between rate group premiums;
- This will ensure the risk borne by a particular motorcycle will be more transparent and will be reflected in its rates; and
- This is not being introduced on a revenue neutral basis, but will be implemented to increase the entire Motorcycle Class revenue thereby minimizing cross subsidization.

However, the Board will not support, in its entirety, MPI's proposal to introduce a new target rate line and adjust the differential. MPI has sought rate increases for various rate groups to be capped at 30%. The Board views this to be excessive and will order a rate group cap at 20%. Therefore the Board will direct rate groups to be capped at 20%. As shown in MPI Exhibit 11, this will result in a 14.91% average increase for motorcycles instead of the 19.93% originally proposed. The Board will further direct that the foregone revenue be recovered by balancing the amount back across all other major classes.

With regard to the current sport bike premium differential of 10%, the Board notes the frequency of sport bike claims is four to five times greater than for the other types of motorcycles. Sport bikes have a frequency of 16.59% which means that one out of six sports bike owners has filed a claim in a given year. With this extraordinary experience, the sport bike premiums can be expected to continue to increase. However, at this point, given the dislocation with the rate line adjustments, the Board will not impose a further increase in the rate differential specific to sports bikes this year.

Fleets

The Board has considered the six issues canvassed by MCTRA in respect of MPI's Fleet Program. These are: MPI's Fleet Survey; allocation of claims expenses; replacement insurance coverage; transparency of the transition from indicated to required average premiums by major classification; prospective versus retrospective rates; and the application of GAAP.

The Board acknowledges that there could have been better communication between MCTRA and MPI in respect of the fleet survey. However, representatives of MPI did attend several meetings with MCTRA, at which the relative positions of both parties regarding fleet issues were put forward and discussed. It is clear that no agreement could be reached. The Board, regarding fleet issues, also notes that there are many fleet owners that are not members of MCTRA. Additionally, all fleets owned by MCTRA members are in the Public vehicle classification, while other fleets, including Manitoba's largest fleet are in either the Private Passenger or Commercial vehicle classification.

The Board considers it to be significant that there are approximately 1,390 fleets in Manitoba and that only a relatively small number (approximately 42) are MCTRA members. The Board does not consider the fact necessarily relevant that fleet premiums for MCTRA members are considerably larger on a per fleet basis than the average for the overall fleet. The Board's view is that the fleet program, as with any other program, must treat all consumers in a like and principled manner, regardless of relative size of their individual paid premium. The Board notes that MPI did attempt to contact all fleet owners, and received in excess of 500 written responses, including several responses from fleet owners that are MCTRA members, as well as receiving a written post survey response from MCTRA. The Board's view is that the ratio of responses to requests is above the norm for such surveys. The fleet survey responses indicate a significant

majority to be in favour of the program as currently exists. Therefore the Board will not require MPI to pursue this matter further.

With respect to allocation of claims expenses, the Board is of the view that a more detailed report could have been prepared by MPI, but it is satisfied that a greater detailed analysis would have yielded little benefit to fleet owners as a group. In arriving at this determination, the Board has considered that many other insurers use the same allocation method as MPI. Additionally, allocations are done at the major class level, and the Board is of the view that a change in allocation methodology would not improve the fairness of the system. The Board believes a change in an allocation method should not be required solely because a different method would advantage a particular group of vehicle owners, representing a relatively small proportion of the entire vehicle population. The Board considers that MPI has met the intent of Order 203/02, and will therefore not require any further study or change related to the allocation of claims expenses.

The Board is of the view that there is no merit to the request of MCTRA respecting replacement insurance. The very nature of insurance is such that premium development, based on past trends, already incorporates the experience that not all vehicles are driven twenty-four hours a day, every day. The Board will deny this request.

As for MCTRA's request regarding calculation of fleet rebates and surcharges prospectively, the Board notes that the majority of fleet owners responding to the survey indicated satisfaction with the program, including the use of retrospective calculation of surcharges and rebates. The Board agrees with MPI's contention that the current system provides an incentive for fleets to minimize claims costs. The Board further notes that no new or convincing evidence was put forward by MCTRA to warrant a change in the method of calculating surcharges or rebates. The Board will not require MPI to change the current methodology.

In Order 203/02 the Board requested MPI to attempt to "...significantly improve the transparency of the disclosure of this transition for the Benefit of MCTRA and other interested parties." MPI filed its response in Section AI.18 of the application, but this response has not satisfied MCTRA. The Board has previously stated that the transition is an extremely complex process requiring numerous iterations and rebalancing calculations. The Board agrees with MPI that providing all of the numerous detailed calculations would not provide any greater understanding of the rate model. The Board notes that MPI has provided the steps used in the transition process and both MPI's management and internal actuary, as well as MPI's external actuary, have signed off on the process as being reasonable. Accordingly, the Board does not consider the additional expense of an external audit process to be warranted, nor will it require an audit be undertaken.

The manner of accounting for the transfer of excess revenues from the SRE and Extension business lines to the Basic RSR will remain unchanged. It is the Board's view that such transfers of retained earnings do not meet the definition of income in the accounting recommendations of the Canadian Institute of Chartered Accountants Handbook, and therefore the Board reaffirms that the current method of accounting for the transfers is in accordance with GAAP and is appropriate for rate-setting purposes.

Claims Incurred

There have been no material changes in the method of forecasting claims incurred. MPI continues to use the Financial Forecast Method to support its requests and reviews the Exponential and Linear Methods for comparison purposes.

In business operations, actual results will vary from estimates, forecasts and projections. The Board is of the view that the likelihood of greater variances exists in the automobile insurance industry because of the many uncontrollable factors that make up the estimated claims costs.

Most of these factors are beyond the control of an insurer, and in the case of MPI have resulted and will continue to result in oftentimes significant variances in claims costs.

The fact that MPI's forecasts are prepared approximately twenty-one months before the end of the forecast period also tends to result in greater variances in actual results. Although MPI's forecasting accuracy of plus or minus 3% is reasonable, the impacts on the net income, nonetheless can be significant, given the magnitude of the numbers being forecast.

The Board's view is that MPI continues to show a reasonable degree of forecasting accuracy, over the long-term. However, the Board is somewhat concerned that the variance has been +10.5% and +5.8% for fiscal 2002 and 2003, respectively. As previously noted, the updated forecast for fiscal 2004 filed as MPI Exhibit #7 provides further evidence of the volatility of revenues, costs and the impacts on net income of such volatility.

Claims incurred costs continue to rise and appear to be escalating at a greater pace than has been previously experienced. The Board notes that total PIPP benefits have increased from $90.5 million in fiscal 1995, the year following the introduction of PIPP, to $179.5 million by the end of fiscal 2003, and are forecast to be $192.9 million by the end of fiscal 2007. The Board is aware that legislated indexation of PIPP benefits has increased costs by over $14.0 million from fiscal 1996 to fiscal 2003, and is expected to increase costs by approximately $2.2 million to $3.0 million per year for the next several years. Additionally, a change in fiscal 2000 to extend retirement injury benefits for the lifetime of a claimant has significantly increased PIPP claims costs. Previously these benefits were fully payable to age 65, then scaling down every year and ceasing at age 69.

The Board is satisfied that MPI is diligent in its attempts to control PIPP claims costs, as evidenced by the descriptions of the various aspects of the control programs, and encourages MPI to continue to do so as well as to explore other avenues to control claims cost. The Board

accepts that it is virtually impossible to quantify savings that can be directly attributed to personal injury cost control initiatives but is satisfied that without such initiatives, PIPP claims today would be much higher. The Board is aware that serious losses appear to be occurring more frequently every year and such losses can significantly impact claims costs in any year. Additionally, the random nature of serious losses can result in major variances between estimated and actual results from year to year.

Physical damage claims costs continue to escalate at a rate similar to that experienced for PIPP claims costs. The Board notes that from fiscal 2001 to projected fiscal 2005, physical damage claims, as indicated in Section 6.1 of this Order, are expected to increase from $223.7 million to $293.0 million which is a 31% increase compared to a projected 36% increase for PIPP claims for the same period of time. The increase in physical damage claims is primarily related to an increase in severity. Severity is increasing because of the increasing cost of parts, and the increasing cost to repair new vehicles equipped with more sophisticated and costly components. As with PIPP claims, the Board is of the view that claims cost control initiatives are being prudently implemented by MPI. These initiatives relate primarily to the use of after market and recycled parts, management of glass claims and control of stereo claims costs.

The Board is concerned, as all stakeholders likely are, about the increasing costs that MPI must recover from Manitoba motorists. The current statistics indicate that overall claims costs are increasing by over 5% per year, while the vehicle population is experiencing average growth of less than 2%. With claims cost increases outstripping growth in vehicle population the impact on motorists will be magnified. From these statistics the Board concludes that costs will continue to increase unless Manitoba motorists take some initiatives on their own, such as changing driving habits and attitudes, complying with existing laws related to impaired driving, seat belt use, and speeding.

Claims and Operating Expenses

The Board notes that there have been no changes in the method of allocating claims and operating expenses between the Basic and the Competitive lines of business. The Board further notes that claims expenses are expected to increase by 6.5% to $69.1 million from 2004 forecast to 2005 projected. Almost the entire increase is attributable to compensation and benefits. Operating expenses are expected to increase by 4.5% to $39.7 million. Of the forecasted increase of approximately $3.0 million in operating expenses, $2.2 million is for compensation and employee benefits.

The Board notes that MPI has budgeted for an increase in FTE positions primarily in claims operations. The Board accepts that it may be reasonable to expect employee levels to increase as the frequency and complexity of handling claims increase. However, as mentioned earlier, the Board expects that the 3.7% increase in premium revenue will be used to fund forecasted operating and claims expenses and allow MPI to break even. The Board expects MPI to take every opportunity to control costs, and use any excess revenue to replenish the RSR rather than fund new programs or initiatives.

Road Safety

In accordance with Order 203/02, MPI circulated the Manifest Report to all stakeholders, including provincial agencies involved in vehicle or highway safety. The Board concurs with MPI that the report was interesting and beneficial; however, it provided limited value with respect to focusing on an appropriate level of expenditure for the road safety program.

The Board notes that both DDVL and MPI participated in the development of Road Safety Vision 2010, with the objective of making “Canada’s roads the safest in the world.” This has provided an existing framework for Manitoba’s key stakeholders. The Board is of the view that the Department of Transportation continue to co-ordinate the efforts of all stakeholders and

perhaps assume a greater leadership role in operational and engineering related road safety issues. Additionally, the Board encourages all agencies involved with the many aspects of road safety to focus on their respective areas of expertise and to review and specific objectives so as to reduce insurance costs for Manitoba motorists. The Board encourages DDVL to discuss, within the confines of its confidentiality requirements, the issue of data disclosure with MPI, with a view to providing timely information to enable MPI to refocus its road safety initiatives.

The Board supports MPI's efforts with respect to road safety awareness and education and encourages MPI to focus its efforts and resources in such a way as to avoid duplicating the efforts and initiatives of other stakeholders.

Information Technology Expenses

The Board notes that MPI has filed the project charter related to the migration from Sybase Powerbuilder to a Microsoft Application. The Board notes that this migration is being implemented in a planned staged approach. At this time there is only a high level estimate of the external cost of $43.9 million and that internal training, change management, and third party oversight costs estimates have yet to be formalized. The Board expects to be fully informed of the decisions made and to review any further project charter changes related to the system migration and to be provided further refined cost estimates at the next GRA.

13.0 It Is Therefore Recommended That:

With respect to Manitoba Public Insurance's efforts in road safety, it should continue to focus its efforts and resources in such a way as to avoid duplicating the efforts and initiatives of other stakeholders.

14.0 It Is Therefore Ordered That:

1. Motor vehicle premiums for the Basic Automobile Insurance Program, for the year ending February 28, 2005, as applied for by the Corporation, BE AND ARE HEREBY APPROVED, subject to the Corporation implementing a 3.7% vehicle premium revenue increase and other changes directed in this Order.

2. Manitoba Public Insurance file an RSR rebuilding plan with the Board if adverse claims experience further deteriorates the RSR.

3. Manitoba Public Insurance implement motorcycle rate increase capped at 20% as shown in MPI Exhibit 11, and the foregone revenue be recovered by balancing the amount back across all other major classes.

4. Manitoba Public Insurance gather data and study the causes of motorcycle risk, to assist in the categorization of motorcycle accidents and investigate whether a form of graduated licensing and or mandated training for motorcyclists would be appropriate, and report back to the Board at the next general rate application.

5. Manitoba Public Insurance file any further project charter changes related to the Sybase system migration and provide further refined cost estimates to the Board at the next general rate application.

6. Manitoba Public Insurance file a revised T1.17 schedule and a revised schedule of compulsory driver and vehicle insurance premiums to be implemented March 1, 2004 and related supporting information, for review and approval by the Board.

The Public Utilities Board

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Chairman

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Acting Secretary

THE PUBLIC UTILITIES BOARD

"G. D. Forrest"
Chairman

"Hollis Singh"
Acting Secretary

Certified a true copy of
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The Public Utilities Board

Acting Secretary