MANITOBA Order No. 96/15

THE PUBLIC UTILITIES BOARD ACT

THE MANITOBA PUBLIC INSURANCE ACT

THE CROWN CORPORATIONS PUBLIC REVIEW AND ACCOUNTABILITY ACT October 2, 2015

Before:

Régis Gosselin, B ès Arts, MBA, CPA, CGA, Chair
Karen Botting, B.A., B.Ed., M.Ed., Vice Chair, Acting Chair
Anita Neville, B.A. Hons., Member
Susan Proven, P.H.Ec. Member
Allan Morin, B.A., ICD.D., Member

MANITOBA PUBLIC INSURANCE CORPORATION (MPI):

DIRECTIVES RE: PHASE I OF APPENDIX "E" TO BOARD ORDER 135/14 ISSUED DECEMBER 5, 2014

REASONS FOR DECISION IN BOARD ORDER 58/15

INTRODUCTION

In its Order 58/15, the Public Utilities Board (Board) provided direction to Manitoba Public Insurance (MPI or Corporation), on four criteria to be used in the process of selecting worst case adverse scenarios for purposes of applying management/regulatory actions in the estimation of capital target levels. The context for these recommendations was Appendix E (Appendix E) to Board Order 135/14.

This Order reflects the Board's reasons for each of the four directives set out in Order 58/15.

BACKGROUND INFORMATION

In Board Order 135/14, the Board repeated that it accepts the Dynamic Adequacy Testing (DCAT) Methodology, in principle but on a preliminary basis, for the purposes of establishing the Rate Stabilization Reserve (RSR) Target Range for MPI's compulsory motor vehicle premiums (Basic). The Board ordered that MPI respond to the document attached at Appendix E to Order 135/14, and that it engage in an open and transparent dialogue among all parties and with notice to interveners, with a view to finalizing Phase I of Appendix E.

In particular, pursuant to Phase I the Board sought recommendations from all parties with respect to the following four criteria to be used in the process of selecting worst case adverse scenarios for purposes of applying management/regulatory actions in the estimation of capital target levels:

1. Whether the capital target level is to be based on RSR level or Total Equity level;

2. An adverse scenario probability level appropriate for a capital target range lower limit;

3. An adverse scenario probability level appropriate for a capital target range upper limit; and

4. The time horizon over which it is reasonable to require adverse scenario capital levels at or above $0 for capital target level setting purposes.

By Order 58/15, the Board provided direction on these four criteria, as follows, to be implemented in Phase II of the process set out in Appendix E:

1. The capital target level is to be based on Total Equity level;

2. MPI shall proceed with Phase II utilizing each of the 97.5th percentile and the 95th percentile as the probability level appropriate for a capital target range lower limit;

3. The Board shall decide the adverse scenario probability level appropriate for a capital target range upper limit at a future time, so MPI shall proceed with Phase II utilizing its recommended basis for setting the capital target range upper limit; and

4. MPI shall proceed with Phase II utilizing each of a time horizon of two years and a time horizon of four years.

MPI Submissions

MPI's recommendations with respect to these four criteria were as follows:

1. That the capital target level should be based on Total Equity;

2. That the adverse scenario probability level appropriate for a capital target range lower limit was the 97.5th percentile (1 in 40 year);

3. The capital target range upper limit should be defined by a 100% Minimum Capital Test (MCT) ratio; and

4. That the time horizon over which it is reasonable to require adverse scenario capital levels at or above $0 for capital target level setting purposes is four years.

CAC Submissions

The only intervener from which the Board received submissions with respect to these matters was Consumers’ Association of Canada (Manitoba) Inc. (CAC). The Board received some submissions from CAC on May 31, 2015, and it received additional submissions on June 2, 2015, after the Board had made its decisions with respect to the four recommendations. As such, the additional submissions of CAC were not considered in the Board's decision making process.

CAC's submissions, as received by the Board on May 31, 2015 were as follows:

1. No position provided;

2. That the adverse scenario probability level appropriate for a capital target range lower limit is the 95^{th} percentile (1 in 20 year);

3. That the adverse scenario probability level appropriate for a capital target range upper limit is the 97.5^{th} percentile (1 in 40 year); and

4. No position provided.

BOARD FINDINGS

<u>Criteria 1</u> - Whether the capital target level is to be based on RSR level or Total Equity level

The Board recognizes that consideration of Total Equity would include Basic retained earnings within the RSR, as well as Basic's Accumulated Other Comprehensive Income (AOCI). AOCI represents an aggregate over time of the difference between net income reflected in the income statement and total comprehensive income, and includes unrealized gains or losses on available for sale securities, among other gains and losses in the investment portfolio. The Board acknowledges that unrealized gains or losses do not constitute a sum certain at any given point in time, but are indicative, nonetheless, of the overall financial wellness of Basic and can be crystalized through the sale of investments.

Given the relevance of AOCI to Basic's overall financial wellness, the Board is of the view that the capital target level is to be based on Total Equity level.

<u>Criteria 2</u> - An adverse scenario probability level appropriate for a capital target range lower limit

The Board recognizes that pursuant to the Basic insurance scheme, and the existence of the RSR, there is necessarily an element of intergenerational inequity, in that those rate payers who contribute to the RSR at a given time may or may not reap the benefit of the funds within the RSR at a later date, when those funds are utilized in the context of an unexpected and non-recurring event. Certainly, the amount of the lower limit of the capital target range will affect how often RSR rebuilding surcharges may be necessary, though the Board recognizes that these probabilities are not linear, such that an estimated 1 in 20 year event does not actually occur exactly once every 20 years.

The Board recognizes that pursuant to the Corporation's DCAT, and the various adverse scenarios reflected within that DCAT, specific dollar amounts can be attributed to each percentile level considered for the capital target range lower limit. The Board wishes to consider further the appropriate percentile level for the capital target range lower limit, and as such requires evidence within the pending GRA with respect to both the 95th and 97.5th percentiles.

<u>Criteria 3</u> - An adverse scenario probability level appropriate for a capital target range upper limit

The Board elected to defer its decision with respect to this question, pending the current General Rate Application (GRA) process, and the opportunity to pose Information Requests to MPI with respect to the MCT, including the target MCT ratio of 100% that MPI proposes.

The Board recognizes that the MCT is an objective measure that can be calculated on a regular basis (quarterly, monthly, etc.), potentially providing an ongoing means of monitoring movement in Basic's relative financial strength. The Board also recognizes, however, that the MCT is a test set by the Office of Superintendent of Financial Institutions Canada (OSFI), and as such the MCT can change and has changed repeatedly. Any future changes to the MCT as implemented by OSFI would need to be considered by MPI and the Board on an ongoing basis, if the MCT were to be implemented relative to the capital target range upper limit.

<u>Criteria 4</u> - The time horizon over which it is reasonable to require adverse scenario capital levels at or above $0 for capital target level setting purposes

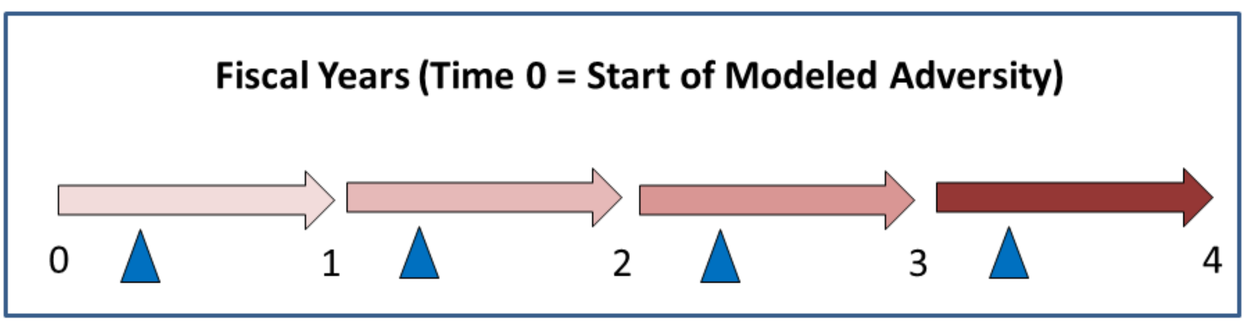
It is the Board's understanding that the definition of "Time Horizon" is as follows:

> *The period over which the test conditions used for capital target setting purposes are applied***,** *i.e., how long the entity is required to remain whole to allow time for extraordinary management/regulatory actions to be determined and initiated (beyond the routine management/regulatory actions modeled in the scenario)*.

The Board understands that a Time Horizon is distinct from a "Return Period", which is defined as follows:

> *The length of the period of sustained adversity, modeled at a particular percentile outcome level.*

The Board has considered the regulatory cycle of MPI, and notes that the following diagram accurately reflects that cycle:



(Note: the blue triangles represent the annual filing of the GRA including the DCAT).

In the Board's view, one year is too short a Time Horizon within which management action can be implemented in response to an event, but two years can meet this requirement. The Board notes the position of MPI that the Time Horizon to be applied is four years, and that MPI will prepare the DCAT on that basis for its own review.

The Board has ordered, therefore, that MPI proceed with Phase II utilizing each of a Time Horizon of two years and a Time Horizon of four years.

THE PUBLIC UTILITIES BOARD

" Karen Botting, B.A., B.Ed., M.Ed."
Member, Acting Chair

“Darren Christle”
Secretary

Certified a true copy of Order No. 96/15 issued by The Public Utilities Board

Secretary