RISK, EVIDENCE AND ASSERTIONS

CLOSING ARGUMENT OF THE CONSUMERS' ASSOCIATION OF CANADA (MANITOBA BRANCH)

2016/2017 MPI GRA

October 21, 2015

Thank You

- Intervenor status
- Joint actuarial evidence
- Careful weighing of the evidence in a principled manner
  - Evidence v. Assertions
  - Need for principle to guide us going forward

CAC Manitoba

- Over two decades of rate hearings
- Core Consumer Rights:
  - To be informed
  - To choose
  - To be heard
  - To consumer education

Developing the CAC Manitoba Position

- Day-to-day consumer contact
- Focus groups
- CAC Manitoba Board

Just and Reasonable Rate Criteria

- MPI onus
  - (rate setting is not about respecting not deferring to CEO judgement)
- Just and Reasonable Rate
  - PUB Act, s. 77
  - CCPRAA, s. 26 (4)
  - Order 98/14, p. 28

Just and Reasonable Rate Criteria

- Forecasts reasonably reliable
- Actual and projected costs - necessary and prudent
- Reasonable revenue needs of an applicant in the context of its overall general health (including reserves)
- Appropriate allocation of costs between and within classes
- Just and reasonable rates in accordance with statutory objectives.
  - Order 98-14, p. 28

Just and Reasonable Rate Criteria

- 26(4) In reaching a decision pursuant to this Part, The Public Utilities Board may
  - (a) take into consideration
    - (v) any other reserves that are **necessary** for the maintenance, operation, and replacement of works of the corporation,
    - (viii) any **compelling** policy considerations that the board considers relevant to the matter,
- Powerful language:
  - Necessary
  - Compelling
- RSR:
  - Tied in a meaningful way to risk – robust analytical foundation
  - Evidence not assertions

What have Manitoba Consumers said?

- Many assertions but what evidence?
  - CAC (MPI) 3-1 a)
- Probe Research (CAC 1-9)
- 2 focus groups (reflective of their views – not general population)

What have Manitoba Consumers said?

- Acceptable percentage increase financially bad year (page 6)
- Risk tolerance (page 7) - more challenging question - asked better in second panel
- Conceptual support for RSR (page 8)

What have Manitoba Consumers said?

- Not inviting massive rate dislocation but level of rate change tolerance perhaps more than CAC Manitoba expected
  - perhaps conditioned by CLEAR adjustments to significant volatility
- Potential contrast Hydro consumers – homogenous product/homogenous price – less subject to volatility than MPI ratepayers in CLEAR era

Caveats regarding citations

- Attempted to either:
  - accurately paraphrase
  - quote directly
- Page citation provided

Potential Strengths of the Manitoba Model

- <u>Potential economic advantages</u>
  - Statutory monopoly basic:
    - dominant player in market:
      - limited choices for suppliers
      - consumer no other choices – no risk of flight
    - economies of scale associated with high volume of transactions
  - No fault – less litigation – more cost certainty
  - Less need to advertise
  - Extremely robust data

Potential Strengths of the Manitoba Model

- <u>Potential social advantages</u>
  - Focused on service rather than profit
  - Invest in Manitoba
  - Greater ownership of road safety opportunities – synergies with DVL
  - Young persons and young males judged on actual rather than presumed risk

Manitoba Model

- In testing reasonableness and prudence:
  - Important to distinguish between strength of model and strength of MPI
- Important to be alive to potential threats or weaknesses to model

Potential Weaknesses of the Model

- Lack of consumer choice = potential lack of market discipline
- Crown Corporation status may place pressure to make decisions for non-insurance (risk) based issues:
  - 1980s
    - "pragmatic" rather than "principled" decisions
    - budgeting for loss
    - preferring rate stability to rates that reflected risks (farm trucks)
    - consumers suffered rate shock

The Manitoba Model
The PUB is our Competitive Advantage

- Regulation proxy for market discipline
- Assurance that decisions are being made prudently, transparently based on risk:
  - Budget to break even:
    - MPI Exhibit 57
      - MPI sought 2.5
      - PUB 3.7 (break even) – CAC Manitoba supported
  - Rates that are actuarially indicated and statistically sound
- costs are kept under reasonable control:
  - Operating costs/external contractors
- Risks are reasonably mitigated
  - PUB leads drive on interest rate mitigation

The PUB is our Competitive Advantage

- CAC Manitoba view:
  - Rate setting approach in Manitoba – superior protection for consumers
  - Don't tell us what Saskatchewan and BC do – tell us how decision was made and what the analytical basis was:
    - In case of RSR was it made after careful public scrutiny or by administrative or political *fiat*
- CAC Manitoba approach to the RSR since the late 1990s:
  - Bring same principled, evidence based approach to setting RSR
  - Minimize the risk for "pragmatic, results based" rather than principled decisions
  - Be able to tie decision to evidence and to risk

What are the Biggest Challenges to Consumers?

- No doubt (all other things being equal) consumers prefer quality service at rates that are relatively low and relatively stable

- But need to recognize that key challenges to reasonable, predictable rates can come from forecast challenges and management challenges

Forecasting challenges have been a significant driver of RSR volatility

- There was some history on our reserving, obviously, that led to the big rel -- release in -- in 2010. There is a period where we had -- we're using, essentially, a normal life mortality table early in the days of PIPP. (Johnston, p. 856)
- We converted that to a, essentially a disabled or long-term disability type mortality table later in the 2000s and it was the experience relative to that table that -- that really led to the **big release** in 2010. (Johnston, p. 856/857) (emphasis added)
  - Major RSR releases since 2006, 2007, 2008 and 2011 – can be tied to forecasting challenges with PIPP
  - Whether we call that inadvertent over collection of revenues or timely releases – still major driver of rate instability has been forecasting

The Management of Interest Rate Risk Continues to be a significant risk factor

- MPI were not looking at interest rate risk separately in our modelling until 2013/14
- So we are wanting to mitigate that downside risk, not lose **the 30 and 40 million that we've been losing in the past.** (Reichert 953)
- Critical Outstanding question – Post ALM – has MPI appropriately immunized/optimized basic portfolio?

Critical Distinction in Perception

- MPI appears to suggest RSR target is the driver of rate instability as measured in RSR rebates

- Has aversion to RSR rebates and surcharges becomes the tail that wags the dog?

Critical Distinction in Perception

- CAC Manitoba says a key driver of rate risks have been MPI forecasting challenges and the failure of MPI to mitigate high risk factors in a timely matter
  - Rate increases to break even are not the enemy
  - Rebates are not the enemy
  - Modest surcharges are not the enemy
- Worry that too much RSR comfort reserves will mute incentive to get forecasting and risk mitigation right

The Purpose of Ratemaking - the Corporation's Perspective

- One of the purposes of rate making is to determine the overall expected costs arising during the policy period. (Johnston 837)

- Another critical objective is to allocate the overall expected costs equitably to all insured. (Johnston 837)

Actuarially Indicated – Statistically Sound

- MR. BYRON WILLIAMS: When we look at the **two (2) primary purposes of rate making**, that's --that's really about the objective of -- of **setting actuarially indicated and statistically sound rates?** Would that be fair, sir?

- MR. LUKE JOHNSTON: That's fair. (Johnston 851)

Equity Among Persons and Groups

- Really all our rate making methodology is doing is organizing the losses into the various categories and using a actuarial or statistical procedure to allocate those costs **as equitably as possible** for rate setting purposes. (Johnston 841/842)

- A good deal of the 1990s was spent trying to achieve a **more equitable allocation of overall expected costs among different groups** of insured (Johnston 845)

Budgeting to break even – not budgeting for a loss

- MR. LUKE JOHNSTON: Yes, our – our rating approach is to -- in terms of **fairness**, is to continue to apply that **breakeven objective** in each rate application. And that's how we **assess ongoing fairness** to each set of **policyholders** in -- in each GRA.

Equity among different generations

- MR. BYRON WILLIAMS: So there's a --in -- in terms of setting the overall expected costs, there's a **temporal fairness** element in that you want to be fair to **today's ratepayers** and to **future ratepayers**, agreed?
- MR. LUKE JOHNSTON: Agreed. . . . (LENGTHY ANSWER excluded) So absolutely this rate application. And -- and I would assume future rate applications will continue to try to break even. And we'll say that that – achieving that objective is equivalent to fairness, from our perspective. (839/840)

An Efficiency Signal

- Q. sending a safety signal in the sense that it's presumed that **if your rates fairly represent your risks**, that will send a message about driving behaviour and vehicle choices and **improve behaviour and choices** (Williams 843)
- A. If you're in a type of vehicle or use or where the rates are higher because the risk is higher, that **might incent you to change your vehicle or your behaviour.** (Johnston 843)
- On the driver safety rating scale, similarly, if your behaviour keeps moving you down the scale. And having higher rates, maybe you'll get the message that, This isn't working out for me. And you'll try to **improve your behaviour** (Johnston 843/844)

Actuarially Indicated and Statistically Sound rates send both an equity signal and an efficiency signal

- Equity = rates relatively reflective of risk
- Efficiency = choices that reduce risk (costs) – reduce rates

Tension in Rate Setting – Equity/Efficiency v. Stability Rate Stability/Rate Shock

- The indicated increase from experience, related changes is capped at 15 percent. (Johnston, 846)
- while the objective of **equitable allocation of costs is certainly important and long standing**, there also is a recognition of the need to temper that adjustment in terms of **mitigating** some of the effect of transition upon the particular motorist or group of motorists. (Johnston, 846/847)
- the other significant purpose of rule 3 is to provide some protection against rate shock for those motorists who might be experiencing a rate increase in excess of 15 percent. (Johnston, 850)

Rate Shock is about individuals not an average

- even in a year of zero overall rate increases, there could be significant movement among individual ratepayers or groups of ratepayers (Johnston, 850/851)

6% for Breakeven

- There does not appear to be a 5% cap for break even rates
- that's always been very **important or the most important objective for Basic insurance.** (Johnston 841)
- MR. BYRON WILLIAMS: And -- and not in terms of any RSR deficit or -- or anything like that, sir, just inflationary pressures or whatever was leading, you know, Mr. Guimond's concern about collisions, if the Corporation reached the conclusion that a break-even rate, no RSR surcharge, was 6 percent, is -- it would be fair to say that your understanding of the Corporation's approach is that the rate increase should be 6 percent?
- MR. LUKE JOHNSTON: Yes, that is my understanding. If we indicated that we needed 6 percent break-even rates, that would be my expectation of -- of our application. (Page 1610)
- 2004 GRA 2.5% sought – 3.7 Ordered with CAC Manitoba support (Page 1824)

Fairness, Efficiency and Stability Best Achieved by removing the potential for pragmatic decisions and by making principled ones based on evidence

- the drive for actually indicating statistically sound rates is -- is driven in -- in the Manitoba context by the desire to reduce the room for political judgment for rate setting and – and ensure that rates, to the extent **possible, are selected based on evidence and principle**? Would that be fair? (Williams, 851)

Concept of Equity not some eccentric CAC Manitoba construct

- Business reason
- Equity reason
- Dr. Simpson and Ms. Sherry not some crusader or outlier with focus on equity
- Not a radical concept
- Central to the ratemaking dialogue in Manitoba especially in Kopstein aftermath

Concept of Equity not some eccentric CAC Manitoba construct

- Ratepayers move to Manitoba
- They leave Manitoba
- Students leave to study, return and leave again (perhaps permanently)
- Persons insure their vehicles for many years and then leave the driving population

Quick Overview of Application Financial Position

Net Income (PF.1)

- 2014/15 – $2.4 M significantly better than forecast due to favourable investment income and collision experience
- Forecast net income $15 M 2015/16
- Project loss $11.4 M in 2016/17 test year (leaving aside interest rate forecast deterioration)
- Project $12.6 M net income in 2017/18
- Given bounce back between 16/17 and 17/18 – MPI considers break even

Quick Overview of Application Financial Position

- **Projected Total Equity (PF.3)**

2014/15	$213 M
2015/16	$233 M
2016/17	$227 M
2017/18	$244 M

- **Contribution from other lines of business**
  - RSR enhanced by $75 M contribution from other lines of business in 2014/15

Just and Reasonable Rate Criteria

- Forecasts reasonably reliable
- Actual and projected costs - necessary and prudent
- Reasonable revenue needs of an applicant in the context of its overall general health (including reserves)
- Appropriate allocation of costs between and within classes
- Just and reasonable rates in accordance with statutory objectives.

Order 98-14, p. 28

Are Forecasts Reasonably Reliable

MPI did not suffer a $82 M loss in 2014/15

- MPI is also projecting a net loss of **$82.5** million for the current financial year. (*Order 135/14*, p. 6)

- Net Income 2014/15 was $2.4 M (see explanation pages 830 – 834)

Interest Rate Forecasting has been a challenge for many years

- CAC/MB raised with PUB in hydro context 2010/11, 2011/12 GRAs
- MPI $30.8 M loss in 2011/12 from low interest rates (MPI Exhibit, 21- Reichert 952)

Interest Forecasting was a challenge in 2014/15

- then, when you come to what actually happened in the year, so **none of the forecasts** of increasing interest rates or at the October time frame of a modest reduction in interest rates, none of those **came to fruition.** We actually saw a hundred and thirteen (113) basis point decline in interest rates over the year. That impact was a **negative thirty-eight point one** (38.1). (Reichert 948)
- Interest rate loss of $38.1 M 2014/15 (MPI Exhibit, 21- Reichert 952)

Interest Forecasting Remains a Challenge in 2015/16

- If it had been based on the Bank industry forecast at September 30th a 1.6 percent rate increase would have been requested. (Reichert 1793)

Ongoing Challenge with Interest Rates and Forecasting

- Should interest rate forecasting methodology be revisited?
- Is there sufficient immunization for basic portfolio?

We note PUB inquiries about use of only one forecaster farther out in forecast period

Recommended Findings Regarding Interest Rate Forecasting

Interest Rate Forecasting:

- Still matters – basic portfolio not fully immunized
- 1.6% rate increase if based on current (rather than spring) forecast

Are Forecasts Reasonably Reliable PIPP

PIPP forecasting challenges have been a major historic driver of volatility

- we're using, essentially, a **normal life mortality table** early in the days of PIPP. (Johnston, p. 856)

- We converted that to a, essentially a **disabled or long-term disability type mortality table** later in the 2000s and it was the experience relative to that table that -- that really led to the big release in 2010. (Johnston, p. 856/857)

Mortality (Termination) Estimation Remains a Major Challenge

- What makes the **mortality estimation so difficult** for MPI is that we don't have like a male/female, non-smoker/smoker. Like it's -- we've got a completely mixed bucket of people. You might have a quadriplegic. You might have an amputation. You might have a mental health issue. Not -- you're not going to get nice consistent buckets. (Johnston, 857)

- We **don't have enough claimants** or people to build our own mortality table. (Johnston, 858)

The Termination Gap

- Turn to CAC 2-1
- The Actual Termination Experience is significantly higher than Expected Terminations
- MR. BYRON WILLIAMS: And there's about a hundred and thirty (130) -- a **hundred and twenty-nine (129) difference** between the actual terminations and the expected terminations?
- MR. LUKE JOHNSTON: Correct. (Johnston, 862/863) (combined table)
- Even taking relapses into account the **experience is still overall positive.** (Johnston, 866)

Phase In of Adjustments to the termination gap

- to the extent that that experience is favourable, which -- which it should be based on these results, we **gradually lower our estimates** from the ten (10) -- from the ten (10) year point and on. (Johnston, 863)
- It's **not fully built in** because we're -- we're trying to move the two (2) together gradually based on our -- our data. But there is an approach in place to -- to move the two (2). (Johnston, 864 – see also Johnston 867)

The Gradual Adjustment is driven by the absence of Manitoba experience

- So that's what you got to be careful with when you make assumptions like on the -- what we call the tail is if -- let's say, we get some **favourable experience** and -- and it indicates – it seems like claims drop about 1 percent, you know, of value between this period. If we then make that assumption on all twenty-three (23) years of PIPP, **it affects all estimates for all those years which can add up to bigger numbers**, right, so you've got to be **really careful** when you're dealing with anything in the tail, which is why we have this **gradual process** to implement it as it's -- as it occurs. (Johnston 869)
- the words you've used are -- are 'not fully built in,' 'gradually'. That would be fair, sir?
- MR. LUKE JOHNSTON: That's correct. (Johnston 869)

Termination Gap matters because it goes to heart of ABO and AB WI estimates

- the relevance of this information, Mr. Johnston, it would go to the projections -- it – it is **relevant to the projections of claims incurred for accident benefit WI as well as other.** Would that be fair, sir?
- MR. LUKE JOHNSTON: Yes, it would be relevant to any claims that are open beyond ten (10) years really. (Page 871)

Termination Gap matters because it goes to heart of ABO and AB WI estimates

- MR. BYRON WILLIAMS: And -- and the **big ticket item** there, sir, is accident ben – benefit weekly indemnity. Would that be fair?
- MR. LUKE JOHNSTON: Income [re]placement and RIB, which we categorize as weekly indemnity would be a big item and then the other one (1) would be ongoing personal care benefits, medical benefits. I can't remember the exact magnitude, but they're **both relatively significant** and weekly indemnity might be a little bit bigger, but not a lot bigger. (Johston 871)

Subject of Regulatory Dialogue for Some Years

- MR. BYRON WILLIAMS: And so you'll recall that some of the thrust of our Information Requests and conversation over the last few years has been the -- the pace at which that experience is – is realized, agreed?
- MR. LUKE JOHNSTON: That's right. Yeah, correct. (Page 870/871)

Is there Quebec insight for long tailed claims

- MS. ANDREA SHERRY: So -- and I guess I bring it up because it's just -- **it's so big. It's so important**. And in **prior IRs**, I've asked if you've ever talked to any other jurisdictions to try to do – get a handle on your tail factor. And I always ask because when I was at SGI, we had similar coverages. And **because we didn't know what the tail factor would be, we went to Quebec.** And they gave us **beautiful data** to use to help us set a tail factor. And I've just **asked in the past** why you won't consider that because they were very – they were fine to share the data. And they've **been around for a long, long time**, so their tail factor was useful. I'm not sure if they still do that, so – but they did when I was there […]
- MR. LUKE JOHNSTON: We're -- we're similar, for sure, yeah. I -- I -- that's -- that's true. We're -- we're comfortable with the approach that we have to -- to modify that -- the mortality experience as -- as it becomes available. We have talked to SGI about their mortality table. I can't recall the result of it, but I -- I get your -- your point that we could work closer with SGI and -- and Quebec to see if their experience is doing the same as ours, particularly in their relapse and -- and extended area that we don't have data on, yeah. I'm -- I accept that. (Pages 1448/1449)

Insight into longer tailed claims may come from Quebec

- MR. BYRON WILLIAMS: But given the spirit of the conversation today, what I think I heard and I'll ask you to confirm, is that moving forward that might be another source of guidance for Manitoba Public Insurance in terms of the development of accident benefit other and accident benefit weekly indemnity?
- MR. LUKE JOHNSTON: . . . And it sounds as though Ms. Sherry has had some success doing that with Quebec, so I -- I would assume that we'd also be able to do that. So I agree it's something that we should look into. (Pages 1597/1598)

Recommended Findings Regarding PIPP Forecasts

- Long standing source of volatility
- Ongoing gap between expected and actual terminations
- Ongoing positive development only gradually being recognized
- Opportunity to gain more insight through longer tailed Quebec experience

Two other important forecasting issues

- Should rates be set on accident year rather than fiscal year?

- Are collision severity forecasts reasonably reliable and sufficiently robust?

Should rates be set on accident year rather than fiscal year?

- Manitoba fiscal year ratemaking approach subject of commentary by Ms. Sherry and inquiry PUB counsel
- Appears relatively unique – even among Crowns
- Mr. Johnston appears to concede departure from generally accepted actuarial practice
- May be some sense by MPI that this was historically required by PUB

Recommended Findings – Accident Year rather than Fiscal Year

- Clarification may be required by PUB
- Raises equity issues:
  - For the 2016/17 year, a consumer who arrived in MB on March 1 of 2016 and left February 2017 would underpay by 4% (based on current forecast) (paying fiscal year costs not accident year costs)
  - Could go other way next year
- Adds some additional complexity in terms of interest rate forecasting risk
  - If you use accident year ratemaking you would only have to forecast investment income out to the accident year in question, not out two years to average fiscal year results
  - Once you have made timing of interest rates less critical, this makes linkage between pricing and valuation much more clear

Collision Severity Trends

- CI, p. 38
  - 17.14% increase 2015/16 (significant increase severity – more normal frequency)
  - 6.38% increase 2016/17
- Negotiations with repair industry may pose significant risk
- Left CAC MB somewhat uneasy especially considering backlog noise from 2013/14
- Tested susceptibility to change in assumptions CAC/MPI Pre-Ask 1
- Ongoing (unresolved) tension Ms. Sherry/Johnston in terms of robustness of trending (probability distributions etc.)
  - Sherry 1425/26
  - Sherry/Jonston 1432/33
  - Gosselin 1433
- Will observe future severity numbers carefully in terms of trends and potential for more robust approach to collision forecasting

Recommended Overall Forecasting Findings

<u>Countervailing forces</u>:

- Adverse interest rate development suggests rate increase especially when coupled with forecast loss for 2016/17
- Offset by PIPP positive developments and potential conservatism
- Uncertainty related to collision – volatility in estimates plus PDR

Overall Forecasting Recommendations

- Interest rate forecasting methodology material and worthy of review next GRA
- Update Quebec results for PIPP and review
- Clarify whether PUB requirement to ratemake on fiscal year
- If not requirement, ask MPI to report back on recommendation of fiscal versus accident year ratemaking

Prudence and Reasonableness: Some Positives

- Mitigation short term operational growth 2015/16
  - Tempering of very significant growth since 2010/11
- Road Safety
  - While jury still out on results
  - Appears to be significant effort to respond to Board Findings, advice of Ms. Johnson and some of the intervenors in this process
- Some mitigation of interest rate risk
  - DCAT results 2014 $168 M – DCAT results 2015 $91 M
- Personal Care Pilot Project (Brandon)

Unfinished Business: Interest Rate Risk Recommended Key Findings

Interest rate risk – many unanswered questions

- Ratepayers have been **unduly exposed** – 2010/11 and 2014/15 – more than $30 M in losses
- Risk have been **partially mitigated** with some **investment income foregone** as a result

Unfinished Business: Interest Rate Risk Recommended Key Findings

- Aon conducted ALM study
  - Aon median income forecasts at **great and unexplained variance MPI forecasts**
  - Would results have been different if used MPI actuals as base (60% bonds duration matching rather than hybrid)?
  - **Hearing suffers** from not having Aon:
  - Risk appears to have been characterized as retained earnings volatility
  - Portfolio conclusions appear dependent on assumption higher and wider RSR Band
  - Appears different portfolio would have been recommended if assumption 10% – 20% of premiums written

Interest Rate Risk Recommended Key Findings

- Still **significant risk associated with duration matching**
- Corporate bonds – appear to have significant opportunity and less overall volatility (although higher downside risk than MUSH)
- Optimization analysis might benefit from comparison with other organizations

Undue Exposure

- And then just to MPI-21 for a second and focusing on the 2011/'12 year, **the $30.8 million negative net impact on interest rates,** that would be the product of a **declining interest rate environment coupled with the fairly significant duration gap** of one and a half (1 1/2) years?
- MS. HEATHER REICHERT: That's correct. (Page 955)

Struggle with Aon Median Income Forecasting

- MR. LUKE JOHNSTON: We did -- **we did struggle a bit** with the **Aon median forecast**, and again it's their -- it's their proprietary model so they're -- you know, we give them information about our claims and assets, and et cetera, and they make their own projections. (Page 1022)

Struggle with Aon Median Income Forecasting

- Median forecast of Aon for the year ended February 2017 **63 million** (Johnston, 1022/23)
- Q. And as compared to the MPI forecast, would that be . . . Negative **eleven point four** (11.4)
- MR. LUKE JOHNSTON: The two (2) models are different, so **comparisons will be difficult,** especially since we **can't verify exactly how Aon** produced this information.

Struggle with Aon Median Income Forecasting

- Aon forecasting a **median net income of MPI of 179 million by the year ended February 2020.** (Johnston, 1023/24)

Concerns could have been addressed by presentation of Aon witnesses

- MPI onus
- Critical risk factor
- Aon expertise should have been available
- Especially given certain challenges in explaining

Hydro GRA – Dr. Kurbursi and McGee

Portfolio recommendations appear highly dependent upon assumptions of risk/reward relationship

- MR. LUKE JOHNSTON: **it's average annual volatility of retained earnings that is -- is the measure of the risk reward relationship.** So as we've talked a lot about in the DCAT and rate stability, that -- that was their measure of -- of how to -- how to calculate volatility. (Page 722/723/724)
- in terms of how Aon measured retained earnings volatility, would it measure it as **rebates and surcharges** from the RSR?
- MR. LUKE JOHNSTON: Yes, that's my understanding. (Page 1018)
- But the frequency of the surcharge rebate -- surcharges and rebates is -- is a big issue, as well, so that has to be considered. (Johnston, 1019)

Portfolio recommendations appear highly dependent upon assumptions of risk/reward relationship

- **desired state** again, that's the MPI/MCT range of 65 percent to 100 percent.
- **current state** is the ten (10) to 20 percent premiums written
- the **return** between the current state and the desired state is very **comparable**
- **volatility** (as measured by Aon) the current state with the duration matching approach and a bond portfolio of 60 percent **perform slightly better** than the desired state

(Johnston 2038/39)

Basic Still Faces Material Risks

- conclusion one would draw from the DCAT, sir, is that from the perspective of the **Basic portfolio** there is still a **material risk** related to adverse interest rate developments (Johnston, 1009)

- MR. LUKE JOHNSTON: Depending on the size of the interest rate change, the -- but if we're talking more than 10, 30, $30 million for larger interest rate changes as being material, which it is, **then I agree with that statement.** (Page 1009)

Tracking Error Significantly Higher with Duration

- the lowest error was the cashflow match at fifteen (15) basis points (Johnston 1015)

- the **highest volatility** would be associated with the **duration match** at one hundred and twenty (120) basis points (Johnston 1015)

Risks Associated with Duration Matching

- duration matching protects against parallel shifts of the yield core -- curve, which explains approximately 85 percent to 90 percent of interest rate risk (Johnston 2011/12)

Risks Associated with Duration Matching

- in terms of duration matching, Aon suggests that -- that the portfolio **could significantly underperform** the liabilities in the case of an **unfavourable yield curve** move. (Johnston 2013)
- If the yield curve -- let's say short-term interest rates rose by twenty-five (25) basis points, but long-term interest rates didn't increase at all, there could be implications given that the liabilities are so far into the future and the -- the discount rate didn't change, essentially, for those liability cashflows, but there may be an impact on assets for other shorter-term interest rate changes. (Johnston, 2014 – **non parallel yield shift**)

Risks Associated with Duration Matching

- **tracking error is the largest** among the hedging strategies. (Johnston 2012)

- if you want tighter matching, that'll come with a price. (Johnston 2012/13)

Corporate Bonds may be a way to mitigate decrease in returns

- **MPI Outlier**
  - ICBC
  - SGI
  - FTSE/TMX

- MR. BYRON WILLIAMS: And just in terms of -- you're not denying that **MPI is an outlier** as compared to the other weights that are -- appear on this page, Ms. -- Ms. Reichert?
- MS. HEATHER REICHERT: No, **I'm not denying** that. (Page 1029)

Strategic Underweight to Corporates difficult to support

- conclusion of Aon is that the stra – **strategic overweight/underweight to corporates** is – is difficult to support (Reichert, 1030)

- long-term corporates offer a **consistent yield advantage** (Reichert, 1030)

MPI Still Investigating

- recommendation from Aon in terms of that the Corporation adopt an acceptable range of corporate bonds within the funds asset allocation targets (Johnston, 1026 - PUB 2-33)

- still investigating that. (Reichert, 1026)

Corporate Bond Trade-off

- MR. BYRON WILLIAMS: And again, Ms. Reichert, just going back to the tradeoff that the Basic portfolio has undergone in the sense that achieving s**omewhat higher protection** against interest rate risk while experiencing somewhat of a **decrease** in terms of its projected **investment income**, that's --that's the tradeoff that -- that essentially is – is represented by the asset liability matching report, agreed?
- MS. HEATHER REICHERT: Agreed, which is why we opted to go with the option that gave us a reduction in risk without sacrificing as much yield as - as the other options that -- that were being reviewed.
- MR. BYRON WILLIAMS: And within that context though Aon is suggesting that there's an **opportunity to increase return without a material increase in risk** through corporate bonds, agreed?
- MS. HEATHER REICHERT: That is what they're trying to suggest; I give you that. (Reichert 1032/1033)

Investment Management

- I'm interested in exploring is whether --what's the **performance of your portfolio relative to the portfolio of other significant funds in Manitoba.** And I'm thinking for example of the Teachers' Retirement Fund, University of Manitoba, and the Winnipeg Foundation. (Gosselin, 878)

Recommended Findings – Come back and Bring Aon

Recommendation

- Come back in a year:
  - Comparisons with other organizations
  - Update corporate bonds
  - Aon to explore unanswered questions
  - Aon on performance to date

Prudence and Reasonableness

BI3 Recommended Findings

- Expected Savings - 2012
  - 75% - reduce claims leakage
  - 25% operating costs
- Original value proposition - 2006
  - tied directly to lowering claims duration
- Johnston: (CAC 14)
  - quite properly concerned last year
  - at least get to BI3 benchmarks – then exceed them

Prudence and Reasonableness

BI3 Recommended Findings

- Unclear whether MPI repositioning in this year's application?
  - Said not judging on durations
  - Rejection of leakage?

Prudence and Reasonableness

BI3 Recommended Findings

- BI3 exists – issue is to understand its successes and challenges
  - Both for ratepayers and claimants
  - Also what it tells us about other IT projects
- Tells us that risks associated with IT and IT business cases – not just short term cost overrun but:
  - Ability to deliver on what they promised
  - Consequences for longer term costs (ie amortization)

BI3 Business Case – 2012 Analysis – Refreshing the Corporation's Memory

- MR. BYRON WILLIAMS: Mr. Guimond, would it be accurate to say that in terms of the **projected savings** in the BI3 business case, the **bulk** of those were associated with the assumed **reduction in claims leakage?**
- MR. DAN GUIMOND: I think **there was a lot of savings in operational costs.** I remember when we went in we had two hundred and twenty-two (222) FTEs. We wanted it down to one eighty (180) for running the department. So it's not just about leakage, no. (Page 932)

BI3 - Refreshing the Corporation's Memory

- So I -- I just want to **stop** this thing about -- this **inference of leakage** and all that stuff. I don't buy into it, just like I don't buy into the intergenerational thing. (Guimond, 935)
- MR. BYRON WILLIAMS: And -- and, Mr. Guimond, the word "leakage" of course is a word that -- it's not my word, it's **your word**, right?
- MR. DAN GUIMOND: I think it's an industry word actually. (Guimond, 935)

BI3 - Refreshing the Corporation's Memory

- And just in terms of the projected benefits, the business case for -- for the Corporation was projecting financial benec -- **benefits of 41.9 million**, sir, agreed?
- MR. DAN GUIMOND: Yes, that relatively speaking we would be paying less than that, yeah. (Guimond 935/936)

BI3 - Refreshing the Corporation's Memory

- MR. BYRON WILLIAMS: Yes. And of that, about **8.6 million** we expected to be related to **productivity** improvements, correct?
- MR. DAN GUIMOND: Yes, that's what it says.
- MR. BYRON WILLIAMS: With **33.4 million** being associated with the reduction in **claims leakage** in -- in the business case?
- MR. DAN GUIMOND: Correct. (Pages 935/936)

2006 - Value Proposition included promise of claims duration reduction

- the value proposition being the use of injury care guidelines to **improve outcomes** and **reduce cost** to settle claims, agreed?
- MR. LUKE JOHNSTON: Yes, I see that.
- MR. BYRON WILLIAMS: And also number 3, the value proposition, recognizing that there are other ones, was a **reduction in average disability claims duration and time loss from work**, agreed?
- MR. LUKE JOHNSTON: Agreed.
- MR. LUKE JOHNSTON: Yeah. At the time this was prepared, that was a -- an expectation or a -- or a target that we thought may be able to be **achieved.** (Pages 925/926/927)

Return to work in a timely manner a central element of risk reduction

- A central objective of MPI is to assist claimants with **returning to the pre-accident status** in a **timely** manner (Guimond, 914)
- Important to the **physical and mental health** of the applicant (Guimond, 915)
- Important aspect of **financial risk reduction** (Guimond, 915)

WI Claims Retention important benchmark

- one of the key benchmarks that MPI monitors is claims retention (Johnston, 917)
- the reason we consistently look at income replacement is because the **benefits are -- are usually relatively clear and consistent.** You get the term in for IRI, and you have a continual income replacement stream. And then when you're back to work, it -- it stops. So it -- it's the **most consistent, easy thing** for us to measure in terms of claims duration. (Johnston, 918)

WI Claims Retention important benchmark

- the benchmark that's employed here is the pre-BI3 initiative benchmark. (Johnston, 919)
- using your example of 2010/'11, you have a **higher number of active claims** being one hundred and four (104) as compared to the **benchmark** of sixty-four (64) (Johnston, 919)
- it seems to consistently run at about thirty (30) -- thirty (30) claims over the -- ignoring the percentages for a moment but approximately thirty (30) claims **over the benchmark** (Johnston, 921)

Last Year's Expectation

- at this point of our conversation last year you were concerned with claims staying longer -- open longer than you would have expected them to stay open, (Johnston, 923 – referring to CAC-14, page 1,363)

- start with BI3 benchmark and then exceeding (Johston, 923 – referring to CAC-14, page 1,363)

Is MPI Repositioning?

- So if you look at the benchmark for BI3, for example, in 2010, when I talk to my staff I don't say, hey, you got to meet the 2010 benchmark or less. That's not how I define success. (Guimond, 898)

- I don't really care if we meet the pre-BI3 benchmark or not. What's important is to understand why it's different or why it's not the same. (Guimond, 928)

BI3 Amortization

- MR. BYRON WILLIAMS: And just so I understand, generally with deferred development costs you would amortize them over five (5) years. Is that correct?
- MS. HEATHER REICHERT: That's correct. Generally it's five (5) years.
- MR. BYRON WILLIAMS: And for this particular project -- pro -- product relating to BI3 we know it will be less, and the question is whether it will be four (4) years or three (3) years? Is that what I'm hearing?
- MS. HEATHER REICHERT: That's correct. (Page 957)

The Cautionary Tale of BI3

- Risk not just cost overrun
- Risk not achieve alleged benefits
- Jury still out

Should inform how we look at PDR and how we prepare for it

Prudence and Reasonableness

Collision Risk and Opportunity Recommended Findings

- PDR
  - MPI ambitious and potentially transformative vision
  - Opportunity to bring more timely estimating and less costs for loss of use – MPI alleges $13 M annual in savings starting in 2019/20

Prudence and Reasonableness

Collision Risk and Opportunity Recommended Findings

- PDR
  - But **significant risk**
  - Issue **much bigger** than originally thought
  - More costs for retooling
  - Unable to bring along all repair shops
  - Need to renegotiate MGEU contract to locate assessors in shops
  - Estimating Risk
  - Will need less service centres likely to close some by 2020 – 2023
  - Uncertainty about IT – Fineos (CAC 2-16)

Prudence and Reasonableness

Collision Risk and Opportunity Recommended Findings

- PDR
  - $1 billion – 4 year contract with repair industry:
    - everything is on the table
    - paying for retooling on table
    - is paying for estimates on table?
  - Important public policy question of **potential contribution from ratepayers to private business infrastructure**
  - PUB has requested disclosure of cost matrices but MPI does not want to provide until after contract negotiated

The Alleged Savings

- you'll see the bottom-line money is starting March 1, 2019, to February 28,2020, is when you see all the savings to the bottom line in its entirety. (Guimond, 974)

- Given so much uncertainty
- So many moving parts
- Significant uncertainty relating to magnitude of alleged savings

Oh-oh, this – this is a game changer

- We **never thought** the **structural change** in the auto industry would be as **significant** as they would be. We never thought that the **investments level** would be as **significant** as they would be. (Guimond, 975)
- And we **never really understood** how -- how, for the first time, MPI would not be able to bring all the shops along -- along since -- since the -- since we started as a Corporation. (Guimond, 975/976)
- It's the first time where people realized that, **Oh-oh, this – this is a game changer.** (Guimond, 976)

Oh-oh, this – this is a game changer

- And we **didn't realize how fast it would go**, and we **didn't realize how much money** it would be. (Guimond, 981/982)

Yet no changes to business plan expected magnitude of costs or savings

Things may still change a lot

- MR. DAN GUIMOND: Yes, I acknowledge I think that it's the distinction of when the project is done versus the transitioning so that the whole ecosystem **can adjust without creating chaos.** That's – that's the thing now between March 1, 2017, to February 2019. That's -- that's -- in the negotiation I think we'll have a lot to say about that. So even what we're thinking **now may very well change** depending how much time the industry will need to **morph** into this new customer service delivery model. (Page 977)

Unable to Bring Every Repair Shop Along

- So for the first time in MPI's history, and we've openly stated that, **we will not be able to bring every repair shop along.** . . . we cannot invest -- **ratepayers will not spend** for Ford aluminum -- Ford 150 aluminum spend a hundred and twenty (120) to two hundred thousand ($200,000) in the two hundred and ninety-seven (297) accredited shops. We're just not going to do that. (Guimond, 892)

Profound Geographic Implications

- MR. BYRON WILLIAMS: Key. And you're the **dominant player** in terms of funding repairs, agreed?
- MR. DAN GUIMOND: Agree. (Page 887)
- MPI has a total of three hundred and twenty-one (321) accredited shops throughout the Province with one hundred and forty-four (144) shops in Winnipeg and a hundred and seventy-seven (177) in the rest of Manitoba. (Guimond, 884, MPI Exhibit 19)
- Now, if we look at what's happening to the structural change in the auto industry, and you're into these certified repaired, qualified repaired, and every year there's new materials, there's new computers, there's new training, tools, facilities. **What does it mean from an investment perspective just by the geography of where the vehicles are?** (Guimond, 892)

Profound Geographic Implications

- Out of the three hundred and twenty-one (321) shops in Manitoba and based on 2013 activity, there were only **twenty-one (21) doing more than twenty (20) jobs per week** And all those were in **Winnipeg** (Guimond, 887)
- of the three hundred and twenty-one (321) shops in Manitoba there were only **nine (9)** doing more than **thirty (30) jobs** per week based on 2013 activity and they are all in **Winnipeg** (Guimond, 887/888)

Implications of PDR on Service Centres

- the reality of the PDR is that, once it is fully deployed, presumably in 2019/'20, that's going to **reduce the space required at service centres** (Guimond, 989)
- But moving forward between 2020 and 2023, there may be a **reduction of service centres** in Winnipeg (Guimond, 990)

Will Fineos be employed?

- BI3 – key it – shorter amortization lives
- MPI appears to suggest Fineos not being employed (Reichert, 957)
- CAC 2-16 appears to suggest otherwise

Four Year Contract with Repair Industry

- magnitude of that four (4) year contract, we're talking in the range of at or above **$1 billion.** (Guimond, 973)
- a **critical element** of discussions with the industry will relate to **issues relevant to the PDR** (Guimond, 972/973)
- issues would include items such as quality control, key performance indicators, accreditation training, (Guimond, 973)

Corporation will not share cost saving metrics until summer of 2017

- the PUB indicated its -- its desire to see the cost containment achievements of the PDR, at least the preliminary metrics, and the Corporation advised that they won't be available till the summer of 2017 due to the ongoing negotiation with the repair industry (Guimond, 984, PUB 1-16)
- the **Public Utilities Board** will in essence **have to wait** till after you've completed your negotiations with the repair industry before it -- it has access to the -- the metrics associated with the -- the cost containment models (Guimond, 985)

Everything is on the Table Including Subsidy to Industry

- MR. DAN GUIMOND: Again, I -- I would respectfully ask that we not go into these kinds of --of questions **because everything's on the table for negotiation.** It's a bit like the other question. I can't remember what the number is of the question, but it was about who pays for the estimate and things of that nature. So I -- I think it's very important that in this forum we not talk about all the things that will be discussed during negotiations. (Page 988)

Who pays for what?

- I suppose you can understand how, from a consumer perspective, there are important public policy and rate implications potentially flowing if issues like funding the -- some of the retooling of the -- of the industry were -- are all on the table.
- MR. DAN GUIMOND: Yes, I acknowledge your customer's point of view, yes. (Pages 988/989)

Recommendations

- Recognize unusual to peer deeply into contract negotiations but
  - Significant opportunities/significant risk
  - Important public policy questions
    - CAC MB grave discomfort with potential subsidies on table to private business - **should we ever be spending auto insurance dollars on for-profit businesses.**
- Significant upside and downside potential collision costs risks
  - There is a significant risk here including estimating risk, dilution of MPI bargaining power

In camera briefing results of distributed estimating – prior to next GRA

Prudence and Reasonableness

- **Recommended Findings IT Staffing**
- **Significant Risk and Opportunity for Savings – IT external contractors**
  - appear higher than peers
  - Guimond admission – then need to address
- **Significant Risk and Opportunity for Savings – IT staff**
  - appear higher than peers

Gartner Group – most recent findings external consultants

- What we're having in terms of the peer average on the right-hand side for the 2013/'14 year. External consultants for the peer average was 24 percent, and in-house was 76 percent (Reichert, 971)

- And the MPI higher at 36 percent external consultants for 2013/'14, and 64 percent in-house. (Reichert, 971)

Gartner Group – most recent recommendation external consultants

- PUB/MPI-1-21, recommendation 4.10, to develop a three (3) year staffing model to ensure key skills are available in house to reduce reliance on contractors and consultants (Guimond, 959)

Mr. Guimond's Acknowledgement of Concern

- **I'm trying to re-explain why we have so many consultants on the payroll versus having more people on our payroll.** So I think it's -- it's something as a Corporation we need to deal with. And I know that in our December joint planning session with our board of directors, that's something that we're going to be discussing in terms of where do we go because **the amount of money involved keeps getting bigger and bigger.** So it's something we need to -- to address somehow and explain ourselves as to why we're doing the things we're doing. (Guimond, 961)
- I just acknowledge right now that when you look at it and -- and **you look at the costs that we're spending on -- on consultants and you look at what could be done maybe on our payroll, that it'ssomething we need to look at.** (Guimond, 961)

Gartner Group Most Recent Findings Aggregated IT Staff (including externals) - as % of FTEs

- peer metric for '13/'14 year was 11 percent and the MPI comparator was 17.2 percent. (Reichert, 968)

- And just so I'm clear, Ms. Reichert, you're looking for a reduction in the relative percentage of IT/FTEs as a percentage of company employee and, Mr. Guimond, you think this is a heroic and good thing? (Williams, 970)

IT Staffing Recommendations

- MPI be directed to provide a plan to reduce external staff in cost effective manner

- Overall IT levels – MPI update on whether current percentage is justified

Prudence and Reasonableness

Road Safety Recommended Findings

- Key issues relating to rural/vulnerable
- Appears to be significant momentum for change since Ms Johnson
- MPI generally saying the right things – test will be in coordinated action based on evidence
- Road safety committee – disappointing subordinate role for consumer organizations
- HSDE – missed opportunity – did not do peer review – internal analysis much less sophisticated

The Disproportionate Rural Impact of Serious and Fatal Accidents

- collisions in rural locations account for, at least in the most recent year, 72 percent of people killed and nearly 41 percent of people seriously injured. (Guimond, 1093)
- disproportionate percentage of the persons killed in traffic collisions and of the persons seriously injured in traffic collisions coming from rural Manitoba (Guimond, 1094)

There appears to have been progress since Ms. Johnson's evidence

- MR. DAN GUIMOND: If we look at section AI.13, you can see the appendix there where we've created the high school driver education program or development methodology, and the operational plan. We've created now the committees, and so on. So I think on a -- on a go-forward perspective, because we have the committees and we have the framework in terms of what things will bubble up that will be important in -- to focus on, so that's -- I step back in terms of me assuming the position that I have now, I think it was more important to not focus on the distribution of these numbers at this point in time but to look at it on a go-forward basis.
- Put the frameworks in place. Make sure people have dialogues. And make sure the frameworks are there to be able to bubble up how the money should be spent. And what are the priorities so that people agree on what are the priorities. (Page 1100)

Absence of Consumer Voice at top tier of Road Safety Committee Disconcerting

- Multi-stakeholder committee that provide feedback
- While road safety issue more narrow – have ability to make changes (bigger scale)

Recommendation: stakeholders at higher tiers of this decision making committee – including vulnerable road users, consumers, seniors, etc.

No Peer Review – High School Education

- Key to road safety HSDE
- Extensive use of external road safety expertise such as the Triple A Foundation for Traffic Safety and Northport and Associates (Guimond, 1104)
- And Northport has done a variety of work for the Corporation, including a longitudinal assessment of -- of the effects of drivers education in -- in reducing convictions and -- and collisions dating back quite a few years now. (Guimond, 1104)
- AAA Foundation for Traffic Safety has done work in terms of the effects of driver's education in reducing collisions in jurisdictions such as Oregon (Guimond, 1104/1105)

No Peer Review – High School Education

- Corporation's report on graduated driver licensing and high school driver education prepared by MPI internal staff. (Guimond, 1105)
- No external peer review. (Guimond, 1105)
- Response to Undertaking 27 makes it clear not of the quality and insight of Northport
- Charter road safety program – proper baseline for status of program – external review

Road Safety/Loss Prevention Recommendations

- MPI generally saying the right things – test will be in coordinated action based on evidence
- Road safety committee – consumer representation higher tiers Road Safety
- HSDE – external review – for baseline going forward

Prudence and Reasonableness

Benchmarking

- Some progress in benchmarks – Gartner group very strong
- Good practice OEB
- More transparency/more certainty for company
- While some progress in out of hearing context, both consumers and MPI have much to learn in terms of engagement

PUB Mandated Performance Standards

- And just so I'm clear and just for a 'yes' or 'no' answer, you're indicating that the -- MPI is not interested in a PUB led working group on benchmarker – benchmarks to develop criteria acceptable for the Board to give guidance in rate setting? Just so I have your answer.
- MR. DAN GUIMOND: That's correct (Page 906)

OEB precedent

- whether or not there would be value in engaging the Intervenors with respect to the issue of benchmarking. (Gosselin, 936)
- but the regulatory framework that has been established by the OEB, which is different than MPI, because it covers a numbers of electric and gas utilities in the province, but it has four (4) groupings for benchmarking, customer focus, operational effectiveness, public policy responsiveness, and financial performance.

Value in regulator facilitated deliberations

Now, I guess what Mr. Williams is getting at is that, you know, expect the regulator to develop these -- this framework in a vacuum is -- is a pretty difficult thing to do for a regulator. I mean, you know, the regulator has -- has a responsibility to ensure that the rates that you charge are – are prudent and just and reasonable.

So -- and expecting us to establish a framework against which we can judge their performance absent from the Intervenors who are, frankly, your clients, it seems to me that we're missing an opportunity there. You know, the -- the way --expecting us to rule on the adequacy of your benchmark from -- from this process that we see in this room, it's a tough challenge to do. (Gosselin, 940)

Value in regulator facilitated deliberations

- So -- so measures that you've developed, I think, are -- are good; they're getting better. But I also think that what would be important to the rate-setting process may be different than what you're setting as objectives on -- on -- you know, with respect to your board, the government, and so on. (Gosselin, 941)
- MR. DAN GUIMOND: It might be something that maybe we should look into more, like,the pros and cons of doing something like this. (Page 941)

Benchmarking Recommendation

- Need to bring structure, creativity and confidence to collaborative discussions
- If decide yes – convene no later than second week of December – PUB sets ground rules of engagement
- Strongly recommend facilitator

Overall Health of the Corporation including Reserves

Recommended Findings

- It is not demonstrated that RSR provides economic net present value for consumers **but** given **compelling policy concerns of rate shock** from extreme magnitude, low likelihood event RSR is a necessary reserve within meaning s. 26 (4)
- **Primary risk mitigation tools** of MPI good management, good forecasting and reinsurance
- RSR is **not** intended to be a **bulwark** against poor management or poor forecasting

Overall Health of the Corporation including Reserves

Recommended Findings

- To preserve RSR value for consumers there must be **clear rules** regarding what RSR should be used for (no gifts to government, no expenditures for capital programs properly streamed through income statement)
- Given issues of intergenerational equity, captive monopoly customers and low probability events, important that establishment of RSR be undertaken on **transparent basis** clearly tied to credible, evidence based, **risk scenarios**

Overall Health of the Corporation including Reserves

Recommended Findings

- Premiums written and MCT (in the absence of DCAT driven level) **do not** provide transparent basis clearly tied to credible, evidence based, risk scenarios
- Most **significant challenge** currently relating to DCAT relates to **combined scenario** and assumption of correlation despite puzzling contra-indications
- Provided combined scenario issues related to independence (rather than assumed correlation) are resolved **DCAT offers meaningful opportunity** for transparent basis clearly tied to credible, evidence based, risk scenarios
- DCAT can then be used to set MCT ratio if desired

Overall Health of the Corporation including Reserves

Recommended Findings

- Setting of RSR through DCAT involves appropriate determination of **risk tolerances**
- CAC Manitoba strong preference for **1/20 to 1/40** risk tolerance but recognize **challenges** in appropriate **range** especially given interest rate scenario and limitations of the floor
- Appropriate upper end risk tolerance should be **less than 1/100 year** event which is linked to solvency analysis

Overall Health of the Corporation including Reserves

Recommended Findings

- Given credible data limitations and material ongoing risks, **options to further mitigate interest rate risk should be explored**

Overall Health of the Corporation including Reserves

Recommended Findings

- PUB find that **time frames** chosen for **equity scenario** are reasonable and **consistent** with approach of **Aon** risk analysis and modern economic era
- PUB find that time frames chosen for **interest rate** scenario are **reasonable** and consistent with modern economic era

Overall Health of the Corporation including Reserves

Recommended Findings

- Failure to allow for fourth year rebound tends to materially overstate the equity scenario
- The determination of **equity risk should be revisited in future years** to provide for fourth year rebound

The Puzzling Nature of the Combined Scenario

- Only material change has been the reduction in the interest rate risk (Reichert, 1002, see also CAC 1-60 c)

- So why is combined scenario higher?
  - Never answered

Issues with the Combined Scenario

- MR. BYRON WILLIAMS: And it would certainly be possible that statisticians looking at these results would probably conclude there is **no reliable evidence** that the correlation between equity reser -- returns and interest rate returns is not zero.
- MR. LUKE JOHNSTON: I -- I think by looking at this someone could draw that conclusion, and that's definitely been part of the development of the history of -- of the combined scenario is what -- what correlation to use. And I don't dispute that for -- in this case **one might conclude that there is none.** (Page 1603)
- MR. BYRON WILLIAMS: And again, it would -- it would be a reasonable hypothesis that when we see these correlation coefficients chan – **change signs**, that this is typical of fluctuations around a **true correlation coefficient of zero.**
- MR. LUKE JOHNSTON: I think it's reasonable for someone to conclude that, yes. (Page 1607)

Issues with the Combined Scenario

- MR. BYRON WILLIAMS: And, Mr. Johnston, in the DCAT methodology, you did run with the assumption that the relat -- there was a correlation between the relationships for the combined scenarios, sir?
- MR. LUKE JOHNSTON: Yes, we did. In my understanding, that was to be consistent and continue to recognize correlation. As -- as **bizarre as these numbers might look** to the -- just the raw, we wanted to maintain a consistent approach was my – my recollection.
- MR. BYRON WILLIAMS: Yeah. And, Mr. Johnston, and -- and in terms of some of our puzzlement about the combined scenario, this might be part of the explanation, agreed?
- MR. LUKE JOHNSTON: It would be sensitive to that, yes.

Aon and Investment Risk Timeframe

AON Attachment B, page 54.

- Longest time period they used was -- for high yield bonds was from 1987 to 2013 (Johnston, 1005)

Are MPI promises realistic?

- GUIMOND - And as long -- that goes back to the benchmarking. As long as we keep grinding to get below that 4 percent natural growth, **like Manitobans will be okay in the sense that they'll never see a rate increase, and they'll -- they'll be protected by the RSR.** And we can review it in four (4) years from now but at least it -- it puts this whole situation that we're in at risk -- puts it over. (Pages 762/763)

Are MPI promises realistic?

- GUIMOND - We don't want -- I guess like where we have an agreement, or a common ground, **is that money should not be extracted to -- from the economy when unforeseen events happen, where you're below the minimum.** You shouldn't have -- so, in other words, in the future -- **in the future, an RSR rebuilding fee should not be required anymore with this -- this -- what I'm putting on the table here.** (Pages 175/176)

Potential for Board Change

- recognizing that there was the potential for a change in provincial government, and recognizing the importance of – of this issue, you were suggesting that it might be prudent to wait a couple of years until 2017 to – to get some direction in terms of DSR (Guimond, 1040)
- chance not only that the government would change, but the MPI Board would change (Guimond, 1040/ 1041)

Money from Extension might not be there

- MR. LUKE JOHNSTON: So this is a standalone Basic 1:40 impact as Mr. Guimond spoke of earlier. If we want to, you know, keep the capital at the minimum, we have the ability, at least right now, to -- to likely prop that up. But this exercise, I think it's appropriate to -- to do it on the assumption that those won't occur and **the money might not always be there to – to do that as well.** (Page 422/423)

Are allegation of privatization overstatement?

- there's no suggestion by the Corporation that looking at the '06 through '09 years that three (3) years of RSR rebates followed by no RSR rebate in 2009 triggered any calls for privatization (Johnston, 1081)
- Manitoba consumers were not storming the barricades of MPI calling for it's privatization as a result of RSR rebates (Guimond, 1081)

Consumers Tolerated Significant Volatility in 1990s

In Order No. 93/97 PUB granted:

- Continuation of the 4 percent load plus an additional 1 percent (Johnston, 1084)
- In addition to the continuation of the 4 percent RS load and the additional 1 percent RS load, there was another Component of the rate increase related to experience-based adjustments averaging 1 percent overall (Johnston, 1085)
- The experience-based adjustment, while it average 1 percent overall you'll see and agree that it -- it ranged from minus fifteen (15) to plus fifteen (15) for certain vehicles (Johnston 1085)

Customers are not Averages

Rate Shock is a highly personal experience

- they're flagging, just as a couple of examples, are a fourteen point seven (14.7) increase, or major increase, as they call it, for the owners of 1966 -- 1996 Chevy Blazers All-Purposes. (Johnston, 1087)
- In addition to individual customers who had significant dislocation, would it also be fair to say that certain groups or insurance uses also had significant dislocation (Johnston, 1088)
- with motorcyclist rising almost 14% (Johnston, 1089)

Rate Pressures were very significant 1996 through 1998

- Exhibit 57 (undertaking 40)
- MR. LUKE JOHNSTON: That's true. There's several years were RSR rebuilding fee was used, and the rate-making methodology continued to produce the usual rate indications which vary plus or minus. (Johnston, 1090)
- MR. BYRON WILLIAMS: And the – the Corporation wasn't privatized after -- after -- in the late '90s or in the early 2000s, sir?
- MR. LUKE JOHNSTON: No, it wasn't. (Johnston, 1090)

The Target has to be Defensible

- **If you are keeping Manitobans money and they have no choice, Manitobans want to know why?**
  - They want to tie it to a risk
  - They want to know they are being treated fairly compared to other drivers
- "Mr. Regis Gosselin: We are looking at a threshold, and – and it's – you know, you – you – a regulator probably doesn't want to be arbitrary about setting a threshold." (page 1409)

DCAT v MCT

MCT 100% not reached in 5000 scenarios

- MS. CANDACE GRAMMOND: Now, Mr. Johnston, would you agree that this modelling result implies that this adverse scenario is at least as remote as a one (1) in five thousand (5,000) year event?
- MR. LUKE JOHNSTON: I believe – yeah, I -- I believe there's a question on that. And I don't have the reference, but our -- our answer was that in -- in this -- at this scale, out at -- at -- in these kind of remote events, our confidence in the probability estimate obviously declines. We're talking about maybe one (1) or two (2) events might pop up here. We're making the assumption that all our models are just perfect, and all it -- you know, like, we know exactly what one (1) in one hundred (100) year events look like, and et cetera, et cetera. But again, as I've already state -- all – already stated, **of the modelling we did run, this -- this one survived all scenarios, so to speak.** (Pages 418/419/420)

DCAT v MCT

- MS. ANDREA SHERRY: But why would a -- okay, so there's two (2) questions I have with that.
- And again, you've gone to all this trouble. **You've built a DCAT. We've spent a whole bunch of time getting to where we are, which is not bad, right?**
- MR. LUKE JOHNSTON: **M-hm.**
- MS. ANDREA SHERRY: **So why are we going to just chuck that instead of using the scenarios that you have for your upper target?** Because the MCT -- I mean, you could take any of your DCAT scenarios **and create an MCT from that**, right? Because --
- MR. LUKE JOHNSTON: Yeah.
- MS. ANDREA SHERRY: -- **your DCAT scenarios have a set of financial statements related to those scenarios. So you could create MCTs from those.**
- MR. LUKE JOHNSTON: **M-hm.** (Page 1397/1398)

The MCT

MS SHERRY - So the MCT is a **state in time indication of a company's capital**. It is run straight from the financial results of the company and it says: Here are the results of the company. That's -- that's what it is. So you can take any result -- any statement or any financial statements and create an MCT. **So it's just basically a summary of the financial health of an organization.**

So the DCAT is something else altogether. The DCAT is scenario testing, stress testing on a company's results. So you can take any DCAT scenario. You can take the combined scenario of MC -- of MPI and I'm sure you might have one this. **You get financial statements out of it and you get an MCT result.**

So an MCT is, like, it's the result of. So when I make a comment such as a hundred percent MCT is arbitrary, what I'm saying is **a hundred percent MCT doesn't link us to any set of risks, it's just a number. But we don't know with certainty what could cause that number because we have no scenario that results in that number.**

So what I'm saying is give us the scenario, tell us what this risk is, and if you want to link it to the MCT, fine, but you don't really need to, **but let's make the ranges based on true scenarios instead of taking this number that's not linked to any real level of risk.** (Page 1473/1474)

The MCT

- MS. ANDREA SHERRY: -- give me a scenario that gets you a hundred percent MCT. And then we can discuss whether that's a plausible scenario. But just a hundred percent MCT, **just it doesn't stand for anything.** (Page 1475)
- I'm not -- I'm not suggesting something crazy. It's done. It's -- it's just as -- it's **more common practice than just throwing a number out there.** Like, we actually **use the DCAT to get that number.** (Page 1476)

Value of Money in Ratepayers Hand

MS. ANDREA SHERRY: Yes. I am aware of that. I'm not sure your typical ratepayer would be aware of that. But when I talk about taking money out of the economy that means that if you take a hundred dollars ($100) extra from your average ratepayer, **that hundred dollars ($100) might mean something to them.**

And they might have -- I mean, this – there is a PUB -- PUB Order quote about this very topic that **the average taxpayer probably has debt that they hold at a higher interest rate**, and they could use it back, that money, to pay off that debt which would benefit the economy. They could shop, which would benefit the economy.

So if you ask that person whether they want the hundred bucks or they want you to keep it to do with what you want, **they would want their hundred bucks.** (Page 1590/1591)

The Risk of Excessive Reserve

So I don't want to suggest rate instability is a good thing, but neither is a huge RSR pot of money sitting there just to make sure that there's never going to be a rate increase. And to be quite honest, a rate increase of 2 percent, I think Manitobans can handle that, right? So it's the – the 5 10 percent we want to avoid, or the 15. (Sherry, 1421)

Capital Targets set by Government in other Jurisdictions

Other Insurance Companies use the MCT

- Quebec?
- Saskatchewan
  - nothing to demonstrate that it is risk based analysis – jurisdiction that was a fair way behind MB
- ICBC
  - No evidence that it was set based on merit or political *fiat*

What is stopping Saskatchewan/ICBC from arbitrarily setting higher MCT?

A principled approach is necessary

- MR. BYRON WILLIAMS: In terms of issues such as the RSR, sir, in finding common ground, would it be fair to say that it's got to be principled common ground such that it can survive the – any particular relationship between the current CEO of MPI and the current -- current Board? It's important that any resolution to the rate stabilization reserve issue be a **principled** one that survives the relationship between you as CEO and this Board and that is one (1) that **future Boards and future CEOs can look to and rely upon, agreed?**
- GUIMOND. . .In -- in five (5) years from now or four (4) years from now I recommend we do a review of that, so -- so principle you have to be -- I'm not too sure what it means to you, **'principled', so I – I think it has to be -- I -- I would -- term to use pragmatic in that it resonates with the public and all the stakeholders.** (Page 1044)

Purpose of RSR

- But as I have understood it, and history has stated, that was not meant to be the purpose of the RSR. Going back to the Kopstein Report of 1989, way back then -- there's a few quotes here. I'm not going to read them. But basically since Kopstein, and I think what Kopstein intended, the Board – there have been several Board orders and several statements of the purpose of the RSR, and I'll just read it here: The stated purpose of the RSR is to protect motorists from rate increases made necessary by unexpected events, and the losses arising from **non-recurring events or factors.**
- And if you look at that, and then you look at the quote from Kopstein saying that: **"Unusual weather conditions and other occurrences are an inherent part of the insurance business."** Then that's -- that would suggest that **variance from budget is not what he intended as the use of the RSR**. (Sherry 1323/24)

Difference between analytical approaches RSR and Solvency

So I might run a crazy adverse scenario just to see what would happen if inflation went up 5 percent, and interest -- you know, I could do that. But I'm not going to turn around and use that to set my rates anywhere. That is purely a test of solvency on a company, right? So what you're doing, is you're tying the DCAT to rates. (Sherry, 1364)

Health of the Corporation including Necessary Reserves Recommendations

- Reject MCT
  - Option 1 – Mechanism
    - continue with premiums written
    - finalize DCAT
  - Option 2 – Mechanism
    - implement DCAT:
      - combined no correlation
      - improve equity and interest over time
  - 20 – 60
  - 20 – 100
- Report on consumer attitudes biannual basis:
  - Rate change
  - Risk tolerance
- *Let's be clear on the low end, the high end, and rebates when you go over the high end.*

Assertions not Evidence

- Note rich-diverse experience of Simpson and Sherry

- Judge Ms Sherry's demeanour

Reality of Monopoly consumers

- Cannot choose basic
- No meaningful options extension

Equitable Allocation of Costs

Allocation of Costs Among Consumers

- **DSR**
  - Significant success story
  - Note PUB and consumers quicker move to level 15 and higher discount for level 15 – well justified
  - MPI says not until 2017

Recommendation

- MPI to report each year on graph of DSR level results
- MPI to report on whether DSR level and discounts commensurate with risks (2017/18 GRA or 2018/19 GRA)

Just and Reasonable Rate

Options

- Evidence to support – 1% rate increase - interest rates and forecast lost already
- Or no overall rate increase
  - Saw off – cushion PIPP and perhaps collision
  - Cost containment opportunities
- 1% rate decrease
  - Cushion PIPP and perhaps collision
  - Prudence opportunities

OTHERS

Recommendation:

- Government should return extension directly to ratepayers.

Thank You

CAC
Manitoba