when the Corporation had a deficit in the Basic RSR of $49.9 million and an overall deficit of $20.1 million. The Board will remain consistent with its past treatment now that the Corporation has total retained earnings of $102 million and a projected RSR balance from Basic of $61.4 million at February 28, 2000. The merit of future rate applications with regard to the RSR target will continue to be viewed in light of the overall financial well being of the Corporation, as well as the changing business risk environment.

The Board also notes that certain filings presented in this application were not consistent with those at the prior year's GRA, for example the information presented on T1.15, 16 and 17. Accordingly the Board directs the Corporation to file schedules T1.15, 16 and 17 in future rate applications in a manner consistent with that presented at the GRA for the 1998/99 year so as assist the Board in its year by year comparison of the Corporation's financial state and its progress to achieving and maintaining adequate reserves.

RSR Target Methodology

The Board agrees that the methodology to use a claims liability approach rather than a premiums written approach in the determination of the target is a reasonable approach for determining an appropriate reserve level. However, the Board does not agree with the primary assumption used in the RSR Review that the four risk components, revenue, claims costs, claims expenses and operating expenses, are perfectly correlated and additive in the determination of the reserve. The Board is also of the view that some form of correlation analysis should be conducted to determine the relationship among the various terms and the extent of their correlation. In addition, investment risk should be considered in the analysis. The Board believes operating expenses should not be considered in the analysis as they are controllable by management and would not be subject to significant variation from expected operating activities.

Given the Board's concerns with certain deficiencies in the revised RSR target resulting from the Corporation's RSR Review, and until those concerns are appropriately addressed, the Board will continue to apply the existing RSR target methodology.

The Board directs the Corporation to provide an updated report at the next GRA on the appropriateness of the RSR target, including comments on any proposed modifications to the revised target presented at this hearing.

Continuation of the 5% RSR Adjustment

The Board has reviewed the Corporation's undertaking related to the RSR scenarios that was filed after the close of the hearing and in reaching its decision, gave weight only to the attached rate scenarios.

The Board believes there is a risk of exceeding the RSR target by continuing the current 5% adjustment, and therefore believes action must be taken to moderate the build up of the RSR. The Board will deny the request for the continuation of the 5% RSR adjustment and will reduce the RSR adjustment from 5% to 4%, effective March 1, 1999. The Board will approve the continuation of the 4% RSR adjustment to fund the Rate Stabilization Reserve for a period of one year beginning on March 1, 1999. The Board also directs the Corporation to provide a detailed plan at the next GRA for the phasing out of the remaining RSR adjustment.

include consideration of budget forecasting accuracy in the Risk Analysis since the RSR is to be used only for unforeseen (i.e., not budgeted) non-recurring events. If the events are foreseeable and, for example adverse, then the Corporation should include them in the revenue requirement for the upcoming year, and therefore should not expect to draw down the RSR. The Board agrees that the Risk Analysis should determine how the variances in the relevant cost and revenue items may impact on net income and cause a contribution to, or a draw upon, the RSR.

The Board was particularly persuaded by Mr. Todd's explanation that the risk to be considered is the risk that actual costs and revenues will differ from the forecast built into rates because the forecast revenues and costs are used for rate-setting purposes. Rates should address expectations of the foreseeable, and therefore should fail to cover the costs of the Corporation only when forecasts prove to be inaccurate.

By way of illustration, Mr. Todd put forth several charts showing that for each of the risk components other than investment risk, the difference between the forecast and the actual is minimal, whereas a comparison of the actual to the long-term average represents an overstatement of the variability. If the deviation from the forecast creates a shortfall or excess in net income, then that affects the RSR. The Board believes it is important to focus on what is driving the RSR. Accordingly, the Risk Analysis should take into account the variance between forecast and actual amounts that directly impact the RSR. In ordering this, the Board expects that the future Risk Analysis will still use the methodology and statistical approach contained in the current Risk Analysis, but will be merely changing the variable inputs.

In Order 154/98 the Board directed the Corporation to undertake a study to determine the actual correlations of the various risk components. The Corporation has complied and as indicated, the difference between the perfect correlation and actual correlation at a 95% confidence level decreases the required amount of the risk reserve from $105 million to $78 million. The Board will require the Risk Analysis to take into account the correlations between the risk components

recognizing the direction of the effect on net income of the various components in the Risk Analysis. In doing so, the Risk Analysis will more accurately reflect the risk of the variance from the forecast to actual.

Similarly, in Order 154/98 the Corporation was directed to include investment risk in the Risk Analysis. A VaR study is becoming a popular methodology for determining investment risk. The Board notes the Corporation intends to perform the VaR analysis annually and expects to have this included for review in its annual rate filing.

RSR Target

In summary, based upon the above mentioned findings, the Board believes that the RSR target set by the Board of Directors of $80 to $100 million is on the high end of the spectrum. The Board is also concerned with issues of inter-generational inequities that arise with the RSR. By its very nature, the RSR creates inter-generational inequity by creating a reserve fund that is to be held until a draw is required. However, the Board is also mindful that the RSR has been replenished by $55 million (excluding the $39 million gain on the sale of investments), by the ratepayers over the past five years.

As stated in previous orders the Board considers the overall financial strength of the Corporation for rate-setting purposes in determining the appropriate level of the RSR. Additionally, as indicated in Order 154/98, consideration of the RSR target in future applications will continue to be viewed in light of the overall financial well being of the Corporation, as well as the changing business risk environment.

The Board believes that for rate-setting purposes, the target for the RSR should be set below the target selected by the Corporation to reflect the expected enhanced stability under PIPP, a decreased provision for operating expense risk, and the methodological change to use a forecast-

surplus remained in the Corporation, the Corporation's Board might use those funds for other purposes in the future.

The Corporation's financial projections for the fiscal year ended February 28, 2002 indicate a net income of approximately $28 million. It is the Board's view that this level of income is not consistent with another stated object of the Corporation that it will break even over the long term on basic compulsory coverage. However, in light of the significant surplus refund already approved, the Board is reluctant to consider a reduction in base premiums at this time in addition to the surplus refund. To do so would seriously impact the accepted principles of stable, understandable, and predictable rates. The net income for the 2002 fiscal year will increase the balance in the RSR at the end of 2002, and should be considered by the Corporation in next year's application by way of a plan for the disposition of any amount in the RSR that is surplus to an acceptable target based on an updated Risk Analysis. In addition, future applications should be prepared based on operating results that are closer to a breakeven, given the significant RSR balance forecast for the near term and the Corporation's stated objective of breaking even over the long term while maintaining an adequate basic RSR.

As previously stated, the Board will approve a one-time surplus dividend of 16.6% to be refunded to each policyholder for all policies issued between March 1, 2001 and February 28, 2002. This one-time surplus dividend should be clearly shown as a separate item on all statement of accounts with the policyholders. The Corporation must carefully manage the communication of this one-time refund so that all policyholders have a clear understanding of premiums that would otherwise be payable, but for the one-time refund.

In the Board's view, the RSR is derived from policyholders, whether directly from premiums and RSR contributions approved by the Board, or indirectly from income earned from the investment thereof. Since policyholders are the sole source of the RSR funds, they should be the sole beneficiaries of any surplus refunds, in accordance with a refund strategy to be reviewed and approved by this Board. In approving this one-time refund, the Board recognizes that the

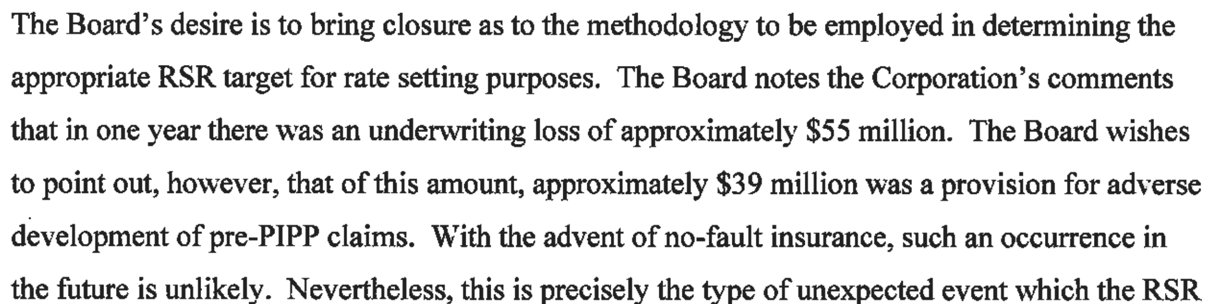
balance of the RSR after the refund may still be considerable and will require a reasonable plan for the future. However, the excess surplus issue is one that likely should not be corrected in one fiscal year. Just as the RSR was built up over a period of years in accordance with an approved plan, so to should any significant excess be dealt with in a reasoned fashion, likely over a period of time that exceeds one year.

Forecasting Net Income

On an overall basis, the Corporation's forecasts of claims costs and other operating expenses since 1994, when PIPP was introduced, has been reasonably accurate. On the other hand, the Corporation has consistently under-estimated its annual premium revenue over the same time period. Higher than expected premium revenues in combination with improved investment income, and gains on sales of portfolio holdings, and approved RSR contributions has resulted in a significant RSR balance, part of which is now being refunded.

The Board understands that claims costs generally will tend to increase over time due to inflation, indexing of Accident Benefits, cost of vehicle repairs, and increased operating costs. While being mindful of the difficulties of precisely forecasting the future, the Board finds the historic trend in understating forecasted vehicle premiums of some concern, and urges the Corporation to focus its attention in this area. In all other material respects, the Board believes that the Corporation's forecasting methodologies and results are reasonable.

Risk Analysis



The Board's desire is to bring closure as to the methodology to be employed in determining the appropriate RSR target for rate setting purposes. The Board notes the Corporation's comments that in one year there was an underwriting loss of approximately $55 million. The Board wishes to point out, however, that of this amount, approximately $39 million was a provision for adverse development of pre-PIPP claims. With the advent of no-fault insurance, such an occurrence in the future is unlikely. Nevertheless, this is precisely the type of unexpected event which the RSR

is designed to cover. The Board continues in its belief that the appropriate tool to establish the RSR target is the Risk Analysis.

The Board wishes to clarify and refine its position advanced in Board Order 177/99 with respect to the means of determining the appropriate RSR target level. The Board will therefore direct the Corporation to utilize the following criteria together in the Risk Analysis in establishing the proper RSR target for rate setting purposes:

- At a 95 % confidence level, both including and excluding operating costs; and
- At a 97.5 % confidence level, both including and excluding operating costs.

Each of the four scenarios should:

- Include only PIPP data;
- Include investment risk using a Value at Risk Analysis assuming a 25% equity component and a time horizon of between two and three years;
- Use variances between forecast and actual amounts for revenues, losses, operating expenses and claims expenses; and
- Use actual correlations between all risk components recognizing the directional effect on net income.

The Board considers the movement to a 25% equity component appropriate since the Corporation's plans for its investment portfolio are expected to take it to this level over the next two years. The two-way treatment of operating costs recognizes that not all operating costs are controllable, and that the "correct" answer will lie somewhere between these two extremes. The use of two confidence levels is intended to focus the review to reasonable levels of risk tolerance. The Board will also encourage the Corporation to review in detail the four recommendations contained in the M&R report, and incorporate these, if appropriate, in the next year's Risk Analysis.

Each of the four scenarios should:

- Include only PIPP data;
- Include investment risk using a Value at Risk Analysis assuming a 25% equity component and a time horizon of between two and three years;
- Use variances between forecast and actual amounts for revenues, losses, operating expenses and claims expenses; and
- Use actual correlations between all risk components recognizing the directional effect on net income.

The Board also encouraged the Corporation to review recommendations made by their actuarial consultants, Milliman USA ("Milliman") on the operational Risk Analysis presented last year, and incorporate changes, if appropriate, in the next year's Risk Analysis.

8.4 Current Risk Analysis

In the current application, the Corporation provided an updated Risk Analysis to review its selection of a Basic insurance RSR target in compliance with the criteria directed by the Board in Order 151/00.

The Corporation engaged actuarial consultants Milliman to conduct the updated operational Risk Analysis, and as in prior years, engaged Comstat Asset Consulting Group ("Comstat") to perform the updated investment Risk Analysis (Value at Risk study). The updated Risk Analysis as filed contained both the Milliman and Comstat reports as appendices to a summary report prepared by the Pricing & Economics Department of the Corporation.

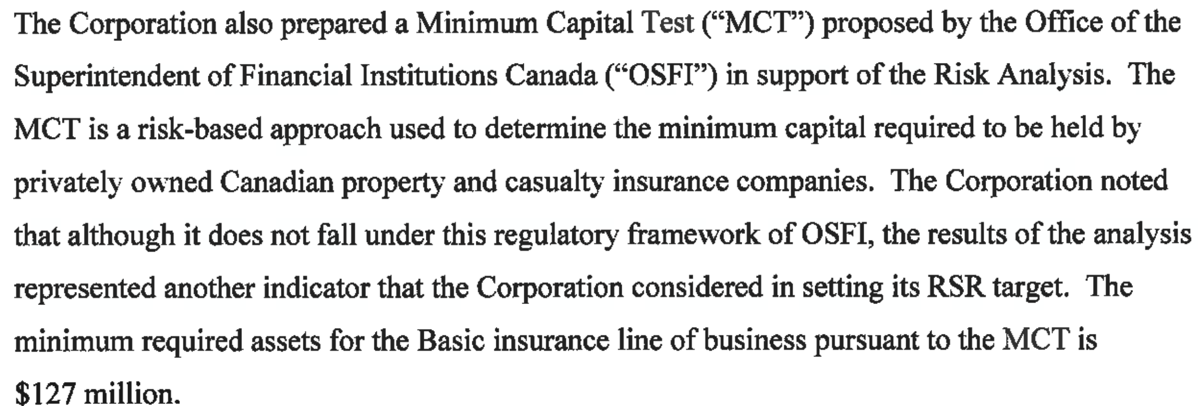
The analysis was prepared with the methodology set out by the Board in Order 151/00. In addition, the Corporation again presented its preferred methodology. The Corporation noted that

the approach prescribed in Order 151/00 restricts the outcome of the analysis to the variance between actual and forecast net income. To address this, the Corporation proposed to assess the underlying volatility of each component of the net income risk uniquely and combine them considering the correlation among the variables. In addition, the Corporation's approach included operating expenses as a risk, while the Board approved approach calculated the risk both including and excluding operating expenses.

The Corporation combined the operational and investment risk components from the Milliman and Comstat analyses, using perfect positive correlation. The Corporation disagreed with the use of the actual correlation between the two components, stating the relationships are not statistically significant due to the short-time period in which risk margins are calculated.

The combined operational and investment Risk Analysis based on the Board approved methodology prescribed in Order 151/00 suggested an appropriate RSR range of $50.7 million to $81.0 million assuming perfect correlation between operating and investment risk, and $39.5 million to $47.1 million assuming actual correlation. The alternative methodology prepared by the Corporation yielded a range of $94.5 million to $131.2 million.

8.5 Minimum Capital Test



The Corporation also prepared a Minimum Capital Test ("MCT") proposed by the Office of the Superintendent of Financial Institutions Canada ("OSFI") in support of the Risk Analysis. The MCT is a risk-based approach used to determine the minimum capital required to be held by privately owned Canadian property and casualty insurance companies. The Corporation noted that although it does not fall under this regulatory framework of OSFI, the results of the analysis represented another indicator that the Corporation considered in setting its RSR target. The minimum required assets for the Basic insurance line of business pursuant to the MCT is $127 million.

The Board has reviewed the summary Risk Analysis and notes that at a 95% confidence level with no correlation and including operating expenses the RSR requirement is $45.8 million while at the 97.5% confidence level, assuming perfect correlation and including operating expenses, it is $81.0 million. Given these results the Board will establish a range from $50 million to $80 million as the appropriate target RSR range for rate setting purposes, and will not require the Corporation to submit an updated Risk Analysis with future GRAs until so directed. However, if there are significant changes to the risk exposure faced by the Corporation in the future, the Board will expect the Corporation to bring forward an updated report at that time.

In its evidence, the Corporation introduced the MCT as a factor it considered relevant in establishing the RSR target. The MCT has been proposed by OSFI as a solvency test for private insurers. In the Board's view the MCT is a capital adequacy test for solvency purposes, which are fundamentally different from the stated purpose of the RSR. Accordingly, the Board finds consideration of the MCT to be of no direct relevance in establishing the Corporation's RSR target for rate setting purposes. Further, any future decisions of the Board that impact the level of the RSR will be made also taking into consideration the overall financial wellness of the Corporation.

The RSR was not designed to address all risks faced by the Corporation but rather to dampen volatility in rate changes. The Board remains of the belief that for rate setting purposes, the RSR should be utilized to protect motorists from rate increases that would otherwise be necessary because of large losses from unexpected and non-recurring events. This is consistent with the Corporation's stated view of the purpose of the RSR. The RSR should not be used to offset base premium increases, which would otherwise be necessary to ensure that forecasted/projected revenue is sufficient to cover forecasted/projected costs in a particular fiscal year. It is the

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.

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

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

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

However, the Board has amended its current RSR range and now believes that a $65 million to $100 million range is appropriate to reflect future increases in Gross Written Premiums for 2009/10. MPI may update the Risk Analysis if it wishes to challenge this range at a subsequent rate hearing. Barring more evidence on the subject, the Board expects to maintain this range through 2009/10. If MPI wants the Board to reconsider the acceptance of the MCT as the

determinant of the RSR range in the future, the Board will require a direct comparison between the MCT and an updated Risk Analysis. The Board is reluctant to adopt a private sector test as the determinant of MPI's RSR range when other means more appropriate to MPI's unique circumstances are available.

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

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

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

Addressing Deficits – DVL and Inter-provincial Trucking

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

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

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

MCT use Going-forward

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

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

Corporation's Board of Directors' current target level range is 50 per cent to 100 per cent of MCT ($107 million to $214 million).

The Board indicated that the current divergent views on how to determine the RSR target range, one based on Risk Analysis (the Board-preferred methodology), and the other based on MCT (as preferred by MPI), was not in the public interest.

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

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

b) Value at Risk Analysis (VAR); and

c) an annual Dynamic Capital Adequacy Test (DCAT).

The Board noted in Order 177/99:

> "… the Risk Analysis should determine how the variances in the relevant costs and revenue items may impact on net income and cause a contribution to, or to draw upon, the RSR…. the risk to be considered is to be the risk that actual costs and revenues will differ from the forecast built into rates because forecast revenues and costs are used for rate setting purposes. Rates should address expectations of the foreseeable costs, and therefore should fail to cover … costs … only when forecasts prove to be inaccurate."

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

The Risk Analysis is a statistical approach devised by MPI to assess its operational risks; the VAR is also MPI-based and complements the Risk Analysis by providing an assessment of investment portfolio risk. According to the 2001 Risk Analysis, the methodology "assesses the underlying volatility … (of risk), and then combines them using standard portfolio principles which considers the correlations amongst the variables, in essence including the diversification effect".

The DCAT takes into account the projected effect of various adverse events, combined or individual, and whether non-recurring (major hailstorm) or continuing (heightened

It is the Board's view that a range of 10% to 20% of net written premiums, to serve as the anticipated normal range of MPI's RSR balance, is adequate, because neither MPI nor the Board is likely to ever propose, let alone agree to, an overall increase in average premiums of more than 10% in any one year.

Given that MPI has $2 billion in investments, has a mandatory monopoly with respect to Basic, which also supports its "competitive" lines of business, records properly established Unpaid Claims liabilities [including a Provision for Adverse Deviation (PfAD), established in accordance with actuarial standards], holds reinsurance against the risk of catastrophic claims events, and has the ultimate fall-back of legislative amendments to restrain claim payouts, the Board is confident that both MPI and the Board would have "time" to adjust to shocks greater than 10% of net written premiums.

If MPI were to carry a RSR balance in excess of 20% of net written premiums there would be a very strong argument for a reduction in overall average premiums and/or a reduction in premiums and a premium rebate, and/or further benefit enhancements (preferably without a retroactive effect).

Accordingly, the RSR range for 2010/11 will be established as $77 million to $154 million, since net written premiums are projected to be $766.5 million. In determining whether MPI's RSR balance is adequate at a given point in time, the Board will consider AOCI, taking into account market changes since the past-year end, changes in MPI's financial forecasts, and other factors (including MPI's overall financial strength and prospects and any plans to amend benefits).

4.3 Cost Allocation Methodology

The Board found both the Deloitte cost allocation methodology report and the evidence of Richard Olfert to be valuable and credible with respect to the development of a revised cost allocation formula for MPI.

The Board is not comfortable, however, in spite of the Deloitte evidence, with concluding its review of MPI's cost allocation methodology at this stage in its development.

Rate Stabilization Reserve and Rebate

For Basic rate setting purposes, the Board considers Basic RSR, Basic retained earnings and segregated balances within Basic retained earnings to comprise, in total, and for rate setting purposes, the overall RSR balance. As of MPI's last audited fiscal year financial statements, that balance, comprised as indicated above, was in excess of the Board's RSR range, a condition that in "normal" circumstances would suggest yet another rebate to Basic ratepayers.

Nevertheless, the Board, being uncertain as to several factors which may or may not negatively impact on future MPI Basic results, will not direct a further rebate be paid at this time.

Pursuant to Board Order 161/09, the Corporation was required to prepare and file an updated Dynamic Capital Adequacy Testing (DCAT) report, an updated Minimum Capital Test and an updated Risk Analysis/Value at Risk study (RA/VAR) on a tri-annual basis. The Board will require MPI to file each of those updated documents with its GRA next year to allow for a fulsome review of MPI's financial situation, prospects and risks.

An updated DCAT and Risk Analysis were filed in this proceeding, and the Board notes that the DCAT suggested an increase in risk was present, an increase that could warrant an increase in the RSR target range of $25 million if DCAT results alone were to drive RSR range changes. The main reasons articulated by the recent DCAT for the increase in the Corporation's risk profile were the higher balance of equity investments and the possibility of increased hail claims. The Risk Analysis also suggested an increase in the Corporation's risk profile this associated with the major IBNR claims adjustments. As well, the Board is mindful of the unusually low yields on government bonds, yields below the current annualized rate of inflation, and the risks to capital values that rests with the risk of interest rate increases (which are generally expected in the market once the economic recovery is considered sustainable).

Despite indicators of an increase in the Corporation's risk profile, MPI did not challenge the existing Board-determined RSR range for 2012/13 of $76 to $152 million.

At next year's GRA, the Board will reassess the Corporation's updated results, updated forecast of future results, and risks, and consider whether the methodology that sets the RSR range should be adjusted going forward. At present, the existing Board-determined RSR range for 2012/13 will continue. For next year's GRA, the Corporation should articulate the pros and cons of amending the methodology presently utilized to determine the Board's RSR range.

Given the Board's concerns over MPI's risk factors; its decision that the methodology establishing the RSR range be revisited next year; the large reduction to Basic rates that will be implemented; and, the Corporation's plans to embark upon significant capital expenditures with respect to IT Optimization (capital expenditures have a tendency to exceed initial budgets and could further test the relatively meagre forecasts of Basic net income going forward now in place); the Board has determined that no rebate be ordered at this time.

The large reduction in overall Basic rates directed herein will result in a significant reduction to revenues from MPI's otherwise higher annual premium revenue, and the Board is not prepared to compound that historically large, and presumably ongoing, annual revenue reduction by directing another rebate at this time.

There are simply too many questions yet to be answered and conditions to be updated for the Board to be sufficiently confident to direct another rebate, now.

Fleet Rebates

The Board has considered MPI's proposed change to fleet rebates and accepts the Corporation's proposal.

Given that, by regulation, the Government has already expanded the fleet rebate scale from one based on a 45% or lower loss ratio to one based on a 37% or lower loss ratio, it follows that changes to fleet rebates should be made. As well, the Board concludes that MPI's goal of matching loss ratios as between fleet and other customers is reasonable (the goal with respect to fleets being the return of approximately 80% of premiums through rebates and claims, and the loss ratio target for Basic products, of 85% of premiums through claims).

6.8 Board Findings

The Board believes that the DCAT methodology is an improved approach for determining the target for the RSR over the current methodology, however, further analysis and discussion is needed, particularly in relation to the adverse scenarios used in the DCAT and the methodology construct, before such an approach should be utilized for rate-setting purposes.

Over the course of the GRA, it became apparent that all parties seem willing to enter into further discussions with a view to achieving a consensus regarding the appropriate adverse scenarios to be used within the DCAT process. Although it was MPI's position that these discussions could take place within the framework of next year's GRA proceeding, it is the Board's view that this discussion is better suited to the less formal process of a technical conference. The Board is pleased that the Corporation is willing to be more consensus based in preparing the DCAT, and that it is receptive to aspects of the adverse scenarios being discussed and revised.

The Board directs MPI to hold a technical conference in early 2013 to discuss, as between the parties to the GRA, the adverse scenarios and methodology construct being utilized currently by the Corporation within the DCAT, with a view to refining the adverse scenarios and gaining a better understanding of the DCAT modeling process.

For 2013/14, and pending the work to be done with respect to the DCAT methodology, the RSR target range will continue to be calculated on the basis of the Percentage of Premium approach, though the Board is not ordering any premium rebate to the extent that the RSR balance exceeds the upper limit of the Board's range as at February 28, 2012.

As in the past, the Board looks to the overall financial strength of the Corporation in establishing rates. The Board notes that on an overall basis MPI is in a financially strong position with retained earnings of almost $374 million while MPI's identified retained earnings targets in aggregate are about $272 million. On a Corporate wide basis MPI has excess retained earnings of over $100 million. The Board believes that MPI should develop a strategy for the disposition of these excess funds to the benefit of its ratepayers. The Board notes that the vast majority of Extension customers are Basic ratepayers and that MPI's dominant market position supports Extension and SRE lines; the benefits that flow to Extension from this integrated relationship with Basic has been an issue raised by the Board and Interveners. The Board will further

the next GRA. The Board also notes that the interveners' experts have not tested the combined scenario approach, and that the relationship between low, sustained interest rates and low equity returns may not be consistent.

In addition, the Board finds that there remains a lack of transparency within the model including with reference to how plausible adverse adverse scenarios are developed and how the model handles changes in assumptions.

On the basis of the foregoing, it is the view of the Board that it is premature to adopt the DCAT approach for the purposes of setting the RSR target or target range. The Board therefore orders that the Technical Conference continue, on the following terms, unless otherwise agreed to by the Board:

- Updated modeling, inclusive of balance sheet and AOCI, per the recommendation of MPI's external actuary, Mr. Joe Cheng, be provided by MPI on or before January 24, 2014. To the extent that MPI needs to engage an outside consultant(s) to complete that work by that date, it should do so;
- Continuation of Technical Conference to be completed by February 28, 2014; and
- Revised DCAT, including changes discussed at the Technical Conference, to be filed by July 15, 2014.

For 2014/15, and pending the Board's determination of the RSR target, the RSR target range will continue to be calculated on the basis of the Kopstein approach as approved by the Board previously.

As in the past, the Board has looked to the overall financial strength of the Corporation in establishing rates. The Board notes that on an overall basis MPI is in a financially strong position with retained earnings of over $325 million, compared with MPI's identified retained earnings targets which in aggregate are about $244 million. As such, on a Corporate wide basis and exclusive of AOCI, MPI has excess retained earnings of $81 million beyond target in its Extension and SRE lines of business. The Board repeats its belief expressed last year that MPI should develop a strategy for the disposition of these excess funds to the benefit of its ratepayers. The Board again notes that the vast majority of Extension customers are Basic ratepayers and that MPI's dominant market position supports Extension and SRE lines; the benefits that flow to Extension from this integrated relationship with Basic has been an issue

For 2015/16, the net financial results in Basic in 2014/15 will determine the RSR balance. The Board understands that the forecast RSR balance will change given movement in interest rates along with other operational factors that will occur between now and the end of 2014/15, and in 2015/16. The Board notes that pursuant to the Kopstein approach utilized by the Board historically, the Board's RSR target range for 2015/16 would be $89 million to $177.7 million, and that MPI's proposed RSR target range for 2015/16, as reflected in the Application, is $194 million (RSR based) or $213 million (total equity based) to $323 million or $325 million (100% MCT ratio based).

So while the target range will not be finalized until next year's GRA, the Board concludes that irrespective of the calculation methodology, whether the Board's range or MPI's range, it is apparent that the current financial position of Basic and the financial forecasts prepared by the Corporation reflect an RSR balance that will be far too low and will need to be increased from current forecast levels.

The Board finds that the Corporation has provided insufficient context for its choice of a 100% MCT ratio for the maximum RSR/capital target, only stating that 100% is a lower ratio than those utilized by other insurers in Canada. As such, the Board does not approve the use of a 100% MCT ratio to set the maximum RSR/capital target. The Board also notes that pursuant to the document attached as Appendix E, prior to the maximum RSR/capital target being set, a determination should be made as to what probability level should be utilized to define that target. Given the projected RSR balance, and in the absence of any unforeseen circumstances, it is apparent at this time that no rebate will be considered next year, such that a maximum RSR/capital target is unnecessary for 2015/16. The Board finds, however, that the MCT is a valuable yardstick that can be utilized to measure MPI's capital adequacy at different points in time for comparative purposes, and orders that MPI file with the Board on a go-forward basis Basic MCT calculations for all years for all scenarios within the annual DCAT report.

As in the past, the Board looks to the overall financial strength of the Corporation in establishing rates. The Board notes that, even though Basic financial results and reserves need to be addressed, on an overall basis MPI is still in a financially strong position with retained earnings of over $320 million as at February 28, 2014 and $358 million as at August 31, 2014, including $188.9 million in Extension and $60.7 million in SRE.