Manitoba Public Insurance

2017
GENERAL RATE APPLICATION

REBUTTAL EVIDENCE

October 7, 2016

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INTRODUCTION

This represents Manitoba Public Insurance's (MPI) rebuttal to the evidence of Mr. Valter Viola, Dr. Wayne Simpson, Ms. Andrea Sherry, and the joint Simpson-Sherry evidence respectively.

MPI disagrees with significant aspects of CAC's intervener evidence. However, in the interest of efficiency, the Corporation has focused on the main aspects of the intervener evidence rather than responding on a line-by-line basis. MPI's silence on a particular matter should not be interpreted as agreement.

MPI Rebuttal to the Evidence of Mr. Viola

The Corporation has reviewed Mr. Viola's evidence, *MPI's Investment Portfolio Risk, Return and Good Practice*, and has grouped his recommendations into three categories:

1. *Recommendations that are not feasible due to limitations imposed by accounting and actuarial standards,*

2. *Recommendations that would undermine rate stability and predictability or have no material impact,*

3. *Recommendations that MPI agrees warrant further consideration, either as part of a future ALM study, or otherwise.*

MPI has organized its rebuttal of individual recommendations around these categories, and offers general comments at the start of each section.

Recommendations not feasible due to limitations imposed by accounting and actuarial standards

Some of Mr. Viola's recommendations are not feasible in light of the requirements imposed by existing actuarial and/or accounting standards.

The recommendation **Pension Liability Accounting** is one instance where Mr. Viola's recommendation cannot be implemented. He states:

> "Reconsideration should also include the remeasurement of employee benefits (approx 15% of liabilities and equities) which is considered OCI. The remeasurement of employee benefits is large (given the long duration of pension liabilities), but OCI arising from changing interest rates that impact the value of pension liabilities is not recognized through transfers to net income under current practices."

MPI agrees that "changing interest rates that impact the value of pension liabilities is not recognized through transfers to net income under current practices." This is due to International Financial Reporting Standards (IFRS) and specifically IAS 19 *Employee Benefits* paragraph 120 which states "An entity shall recognize the components of defined benefit costs…as follows… (c) remeasurement of the net defined benefit liability (asset) in other comprehensive income". On its face, Mr. Viola's recommendation is a contravention of current IFRS standards and would result in a qualified opinion by our external auditors.

If Mr. Viola is recommending that the Corporation keep two sets of financial records, one for investment purposes and another for public reporting, MPI views that this is incompatible with his other recommendation for more "comparable, relevant, transparent, understandable and subject to less potential bias" accounting treatment. Further, MPI does not consider keeping multiple sets of financial records to be "good practice" from a resource and efficiency perspective, or best practice for accounting purposes.

Mr. Viola's recommendation **Delinking Interest Rates** also cannot be implemented. This recommendation states:

> "For purposes of long-term asset allocation decision-making, MPI should consider "breaking the link" (recursive) between liability valuations and the yield on some of its assets. Economic theory suggests this approach is more appropriate."

This recommendation directly contravenes actuarial standards. Per Canadian Actuarial Standards of Practice 2240.01:

> "The expected investment return rate for calculation of the present value of cash flow is that to be earned on the assets, taking into account reinsurance recoverables, that support the insurance contract liabilities."

Recommendations that undermine the goals of rate stability and predictability or have no material impact

MPI seeks to promote rate stability and predictability, and these objectives have also been reflected in PUB decisions for many years. Several of Mr. Viola's recommendations would tend to produce greater volatility of net income and/or Basic rates. These objectives could also have possible implications for the minimum Rate Stabilization Reserve (RSR) requirement.

Some of Mr. Viola's recommendations relate to elections[1] that MPI has made under accounting standards. Mr. Viola appears to favour elections that would tend to move towards reflecting the market value of investments in rates, as opposed to using book value. MPI understands these proposals would tend to move towards the approach taken by pension plans, but such an approach would be a departure from how MPI has operated and been regulated for many years. In general terms, where accounting standards have allowed the Corporation to make elections, MPI has chosen the approach that best promotes rate stability and predictability. The PUB

[1] In some instances, applicable accounting standards permit companies to make a choice as to how to proceed. This is referred to as an "election" under accounting standards.

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has set rates consistent with this approach. By contrast, the use of market based valuations as favoured by Mr. Viola may increase volatility in net income. Including volatile items in ratemaking could undermine the Corporation's goals of rate predictability and stability. Mr. Viola's recommendations, and the volatility that they bring, may also put upward pressure on the minimum target for the RSR.

Mr. Viola has also made recommendations around asset class exposure and constraints that he views could be costly. The Corporation's intent at this time is to mitigate interest rate risk and volatility in premium rates. Consistent with prudent management practices, the Corporation regularly reviews its circumstance and direction, to assess opportunities to improve performance to the benefit of ratepayers. If future circumstances warrant re-evaluation of the Corporation's risk/reward posture, the Corporation will do so at that time.

In what follows, the Corporation offers specific comments on Mr. Viola's recommendations that relate to these considerations.

Mr. Viola's recommendation, **Clarity of Accounting Choice** states:

> "MPI should clarify what flexibility it has regarding the accounting for asset and liabilities while remaining GAAP-compliant, and the factors it takes into account in electing to use one method/assumption over others."

MPI has identified the accounting choices in the notes to the financial statements for the Corporation in Note 3 Summary of Significant Accounting Policies.

When accounting policies are reviewed, all relevant factors are taken into account. The key considerations are – (i) what is IFRS compliant, and (ii) how do the choices impact the key corporate strategic direction of rate stability and predictability. Options that would cause more volatility in net income, and as a result more volatility in the premium rates required to breakeven, would undermine rate stability and predictability.

Mr. Viola's recommendation, **Adoption of More Comparable Accounting Principles** states:

> "In measuring its investment portfolio and liabilities, MPI should consider adopting accounting principles, where GAAP allows MPI to make such elections, that reduce the discrepancy between net income and comprehensive income (as these terms are currently defined by MPI), to improve comparability across all assets as well as liabilities. Comparability would be improved, for example, by accounting for more assets in a way this is consistent with the treatment of financial assets and liabilities at fair value through profit or loss ("FVTPL")."

MPI disagrees with Mr. Viola's view that accounting policies should be chosen to reduce the discrepancy between net income and comprehensive income to improve comparability. Rather, accounting principles and policies should be chosen that align with the nature of the assets and liabilities.

Mr. Viola's recommendation **AFS and HTM Accounting** states:

> "Unrealized gains and losses for AFS assets (approx 20% of assets), for example, are reported as "other comprehensive income (OCI)" and are excluded from net income until realized, making the net income recognition for unrealized gains on equities (approx 18% of assets) inconsistent with FVTPL assets. The treatment of HTM Bonds (25%), recorded at amortized cost, should also be re-considered.
>
> Market valuations are generally more comparable, relevant, transparent, understandable and subject to less potential bias than valuations in reports that are based on MPI's current accounting practices."

This recommendation appears to be premised on a general statement around market valuation being more comparable, relevant, transparent, understandable and subject to less potential bias.

The held to maturity bonds are not marketable (there is no market place that exists to trade these bonds) and they are not sold prior to their maturity date (they are held until the bonds mature due to the lack of an open market). Reporting these bonds at "market value" is not an option.

It is true that unrealized gains and losses on AFS assets are excluded from net income until realized. These AFS assets are equities, which have significant market volatility, are held by MPI for the long term, and are reflected at market value in Total Comprehensive Income.

Mr. Viola's recommendation **No International Equities** states:

> "The appropriateness and prudence of having no exposure to International Equities should be reconsidered, given the large size of non-US foreign markets, the return opportunities that are potentially available from those missed opportunities and the effects of increased international diversification on long-term market risks."

International equities were one of the asset classes included in the optimization for the ALM study conducted by Aon Hewitt. However, in Aon Hewitt's analysis only the riskiest portfolios included an allocation to international equities. In fact, Aon's response to PUB (MPI) 1-82 (b) showed that reallocating 1% to 10% from Canadian equities to international equities was suboptimal as it decreased the return of the investment portfolio (and for the highest allocation increased the volatility).

The portfolio recommended by Aon Hewitt did not include an allocation to international equities, given MPI's primary objective was to reduce the potential for investments to result in rate volatility.

Mr. Viola's recommendation **Integration of Real Estate/Infrastructure Liabilities** in Duration Management states:

> "MPI should consider the liabilities arising from all sources (i.e., including real estate and infrastructure) in its interest rate risk management practices (duration), to be consistent with its management of risks arising from insurance, pension and other liabilities.
>
> The financial leverage assumptions used in Asset-Liability Studies that support long-term asset mix decisions should be made consistent with the leverage actually used in the portfolio, removing the ~ 4% difference related to real estate debt."

Changing the financial leverage assumption by 4% would not have made a material difference to the overall portfolio mix, or to the 10% allocation to real estate.

Recommendations that warrant further consideration

MPI considers that the following recommendations warrant further consideration, in the context of the next ALM study. MPI notes that some of these points were considered at the time of the last ALM study, but were not pursued given the Corporation's then prevailing risk appetite in light of the circumstances around the RSR.

The following table presents Mr. Viola's recommendations that MPI, while not specifically endorsing at this time, will consider and assess the merits of as part of the next ALM study. Where appropriate, MPI has offered additional context around its agreement to consider a recommendation as part of the next ALM study. The Corporation intends to conduct ALM studies on a 4-5 year cycle, and does not anticipate conducting another study until 2018 to 2020.

Table 1 - Recommendations for the next ALM Study

Mr. Viola's Recommendation	Details of Mr. Viola's Recommendation	MPI Response	Context for MPI Response
Return/Risk Definitions for Asset Mix Decision	"MPI should re-define return/risk used to inform its long-term asset mix decisions to be based on valuations that reflect market values, rather than accounting ones (which may be materially different). At a minimum, net income should be replaced by comprehensive income in the numerator (return) and retained earnings should be expanded to include accumulated other comprehensive income (AOCI) in the denominator (risk). In the long term, market returns and market risks will determine average long-term premium rates, regardless of how assets and liabilities are accounted for under GAAP.	MPI will consider this recommendation at the time of the next ALM study.	The previous ALM study was conducted in the context of the prevailing treatment of net income and the prevailing approach to setting the RSR range.

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Minimum Risk Portfolio	A minimum risk portfolio (for market risk) should be clearly defined. It should be aligned with the interests of relevant stakeholders, with clarity regarding the short-term and long-term factors that impact rate sustainability and other important outcomes.	MPI will consider developing a minimum risk portfolio at the time of the next ALM study	A minimum risk portfolio was developed with a prior ALM study, and will be considered again.
No Over-Reliance on Quantitative Modeling	MPI should be vigilant about its potential over-reliance on quantitative considerations, given the high sensitivity of optimal asset allocations to seemingly small changes in capital market assumptions (returns, volatilities and correlations) and the large number of inputs.	MPI believes that its reliance on quantitative considerations has been appropriate. MPI will continue to be vigilant about potential over-reliance on quantitative modeling for the next ALM study.	The Corporation selected the min/max constraints for the ALM study in order to prevent over-reliance on quantitative modeling. These constraints ensured that the results were reasonable & implementable.
Exclusion of Real Return Bonds	The role that RRBs can play in effectively managing relevant risks should be discussed, with consensus achieved regarding the effectiveness of RRBs from a risk management perspective (i.e., independent of the cost of any "insurance" as measured by RRB yields and their expected returns)	MPI will take this recommendation under advisement for the next ALM study	The merits of an asset class cannot be assessed independent of its cost. Aon Hewitt specifically recommended not including RRBs in the asset allocation as they concluded that other asset classes provide inflation protection at a more reasonable cost.
Min/Max Asset Class Constraints	The minimum/maximum and other constraints imposed on the portfolio (e.g., when asset-liability studies are conducted) should be reviewed and relaxed, to avoid costly constraints (lower risk-adjusted returns). The rationale for imposing any such constraints should be made explicit.	The minimum/ maximum constraints can be reviewed for the next ALM study.	Constraints are required in an ALM study because the optimizers used for ALM studies are very sensitive to the risk, return and correlation assumptions and can produce unreasonable results. Therefore, it is necessary to set constraints to ensure that the recommended portfolio is investable by the Corporation. For the 2015 ALM study, dollar and duration matching the fixed income

			portfolio to claims liabilities was recommended by Aon Hewitt as the most prudent interest rate risk mitigation strategy. This strategy required an allocation to fixed income of approximately 70%. A further 15% of the portfolio was previously invested in alternative asset classes (real estate and infrastructure). The decision to invest in alternative asset classes was made in 2008 with the understanding that investment would not be easily reversed due to the illiquid nature of these asset classes. The minimum allocation to Canadian equity was set at 10% in order to ensure a meaningful allocation to Canadian equity.
Canadian Equities' 10% Minimum Allocation	The appropriateness and prudence of having a 10% minimum weight to Canadian Equities ("to retain a meaningful exposure to home markets") should be reconsidered, given the different interests of different stakeholders (e.g., employees through the pension plan), the concentrated nature of Canada's equity market, and other such relevant considerations.	MPI will take this recommendation under advisement for the next ALM study.	A 10% percent allocation to Canadian equities has benefits not mentioned in Mr. Viola's report. Canadian equities provide a closer economic and inflation link to MPI's liabilities without currency risk that U.S. or international equities would include.

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The Corporation has reviewed the following recommendations and is in general agreement that the issues identified in each recommendation warrant further consideration. MPI also highlights that some of points below are already under consideration. The timing for any conclusions the Corporation may draw about these recommendations will be impacted by various factors including any strategic direction the Board of Directors may deliver, and any potential input or direction from Government related to the management of the portfolio. If, after due consideration, the Corporation opted to implement any of these recommendations, timeline estimates for implementation could be offered at that time.

Table 2 - Recommendations for further consideration

Recommendation	Details	MPI Response
Evolved Risk Framework	An evolved risk framework should be considered to improve portfolio/risk measurement, management and/or governance.	This is a fairly general recommendation. The Corporation already examines its risk framework as circumstances change, and will continue to look for ways to improve the risk framework.
Explicit Risk Management Goals	Among other things, the risk framework could include explicit goals related to market risk management (as well as goals related to other types of risk if those require enhancement)	See above.
Removal of 105% Rule in Investment Policies	MPI should remove from its Investment Policies the ability to request external managers to realize gains (losses) ("105% Rule"), which MPI says "is no longer relevant"	MPI agrees and will adjust the investment policy statement accordingly.
Pension Fund	The interests of all relevant stakeholders should inform decisions regarding both the accounting for and management of the assets and liabilities related to the pension plan and other employee benefits. A desirable outcome is to have greater clarity around the appropriateness and prudence of maintaining different types of assets and liabilities commingled in one fund.	The Corporation is already considering the appropriateness and prudence of maintaining assets which are held to offset different liabilities commingled in one fund ie: the merits of segregating pension assets.
Effectiveness of Duration Policy	The effectiveness of the duration policy should be reviewed, given the inherent risks of changing real interest rates and unexpected inflation arising from MPI's liabilities, and exposure to changes in nominal interest rates	Various potential interest rate risk mitigation strategies were reviewed by Aon Hewitt and duration matching was recommended. The effects of changes in inflation and real interest rates were considered in Aon Hewitt's

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	in the MPI portfolio (i.e., nominal bonds without inflation protection). More specifically, MPI should re-assess the effectiveness of its duration-matching strategy since inflation (actual and/or expected) may differ from current expectations.	analysis. The effectiveness of the duration policy and the duration matching policy with respect to inflation will be reviewed by the Corporation.

MPI rebuttal to the Evidence of Dr. Simpson

The Corporation offers the following comments in response to Dr. Simpson's *Note on an Interest Rate Forecast Risk Factor (IRFRF) and the RSR Target Established by the Dynamic Capital Adequacy Test (DCAT)*.

The IRFRF is a response to unique circumstances

Dr. Simpson states that it is "important to note that there is no other insurance company or jurisdiction in Canada or North America that uses a concept such as the suggested IRFRF", and is critical of the Corporation's proposed IRFRF on that basis (page 3, para 2). The IRFRF is a means of reconciling the PUB's Order to use the Standard Interest Rate Forecast and MPI's expectation that doing so will prolong the systematic under-collection of premium that has occurred for several years. The Corporation is not aware of any other P&C insurers in any other jurisdictions that face the same issue of premium under-collection stemming from the same cause. MPI therefore would not expect that mechanisms similar to the proposed IRFRF would exist.

The IRFRF addresses break-even rates; the RSR addresses variability around break-even rates

Dr. Simpson maintains that the "risk associated with a forecast that overstates the rate of growth of interest rates between 2017/18 and 2020/21 is already addressed in the DCAT Report (Volume II)." He characterizes MPI's request for an IRFRF as double-counting the interest rate decline scenario that is reflected in the DCAT (p.4). In fact, the RSR and the IRFRF, while related, are not substitutes for one another.

The Corporation is mandated to achieve break-even net income[2], and this requirement exists regardless of the level of the RSR, or composition of targets for the RSR range. MPI's forecasts must be based on best estimates in order to produce a legitimate estimate of breakeven net income.

The IRFRF is intended to achieve a best estimate of break-even net income, through the use of a best estimate of forecasted interest rates. The RSR is meant to accommodate variability around a best estimate of break even rates. The RSR is responsive to improvements in the best estimate of breakeven rates: the minimum RSR target will decline to $159 million as a result of the 50/50 interest rate forecast.

Negative implications of systematic under collection of premium

Using the RSR to facilitate setting rates with the expectation that they would be deficient is not only contrary to breakeven rates, but also has negative implications for the Corporation and customers alike.

Systematically under-collecting premiums, which can occur by relying on optimistic interest rate forecasts, results in the accelerated drawing-down of the RSR. It diminishes the protection that the RSR provides from unexpected variances from forecasted results and losses arising from non-recurring events and factors. If the RSR is depleted below the minimum target, the funding to replenish it must come from either an RSR rebuilding fee, or if the situation so warrants, a transfer of excess equity from competitive lines of business.

In the current circumstances, MPI would anticipate seeking a rebuilding fee to address shortfalls associated with the continued use of the SIRF. MPI understands

[2] See CAC (MPI) 2-34 (d) for a further discussion around the break-even requirement, as it is established in the Kopstein report and the PUB adoption of this principle for ratemaking purposes.

See also Attachment A to this rebuttal evidence for excerpts of the Kopstein report related to the break-even requirement that this might result in a significant increase to premiums. However, MPI has already transferred significant excess equity to rebuild the RSR in successive years, which was necessitated in part by premium rates that have been set too low due to the use of the SIRF. The Corporation's management must act in the best interests of the Corporation as a whole, and management is of the view that transferring more capital to compensate for the continued use of the SIRF is contrary to the best interests of the Corporation. MPI believes that staying true to the principle of breakeven ratemaking necessitates discontinuing the use of the SIRF at this time.

MPI has not stated interest rate stagnation is a foregone conclusion

Dr. Simpson states on page 5: "The argument that the RSR is not equipped to handle systematic forecasts errors (PUB(MPI)1-13) seems to argue that interest rate stagnation below the SIRF is a foregone conclusion and hence not a risk (despite language justifying the IRFRF to the contrary)…". This is an incorrect characterization of MPI's position. The data presented by the Corporation and by Dr. Cleary demonstrates that the SIRF has performed poorly, and MPI has concluded that the SIRF is not a best estimate of future interest rates. Interest rate forecasting is inherently uncertain, but the proposed "50/50" interest rate scenario is presented by the Corporation as a best estimate interest rate forecast, which in turn produces rates based on a best estimate of break-even net income.

MPI response to PUB (CAC) 1-1

In response to question "Is Dr. Simpson of the view that the current so called "Standard Interest Rate Forecast" is a best estimate forecast?", Dr. Simpson states:

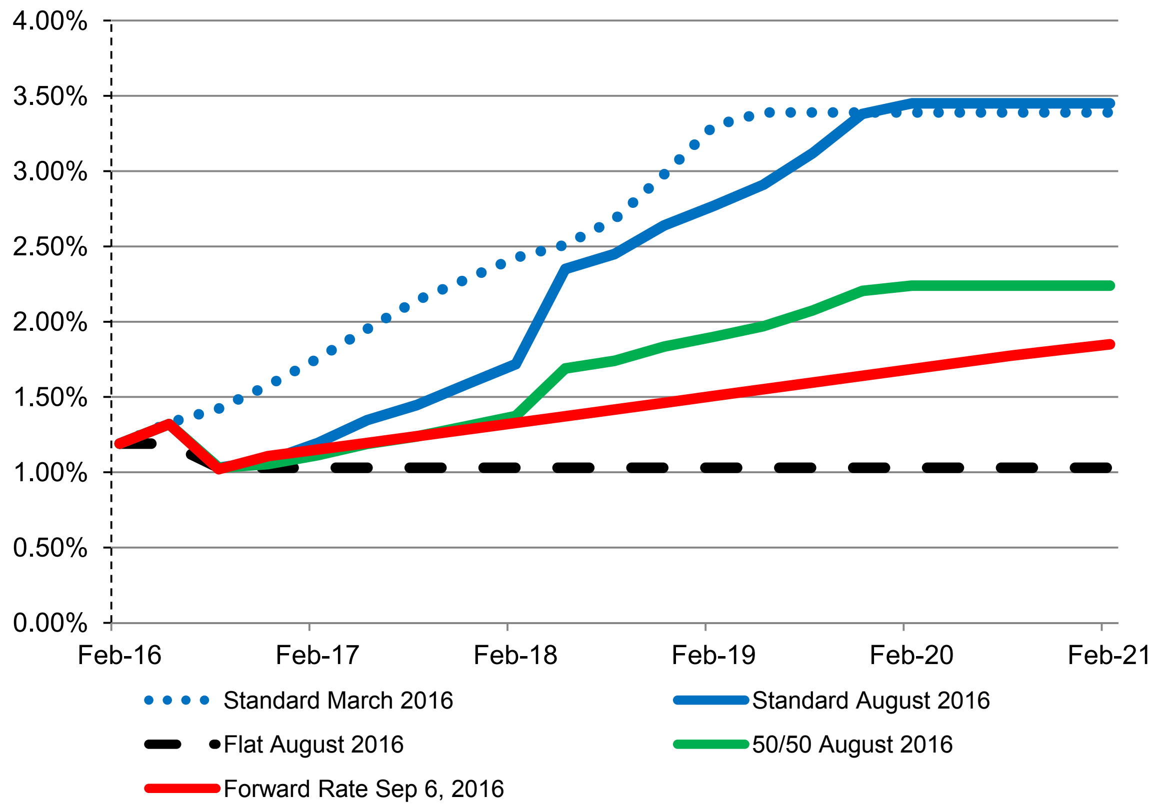
> 2) Insofar as the SIRF is a consensus forecast of respected financial institutions with a large stake in accurate interest rate forecasting who have been conducting forecasts for a long time, I would not consider myself qualified to do better. I would also note that MPI has relied on these forecasts for some time, e.g. in their DCAT reports as the basis for the base forecast.

3) My response to question 2) is a nuanced yes.

MPI used the SIRF in the DCAT base scenario because the PUB has ordered MPI to use the SIRF. MPI has been expressing concern for some time that the SIRF is consistently overstating interest rates, and has now re-run the DCAT base scenario using our best estimate interest rate forecast.

The market does not appear to accept the SIRF either. The following chart presents the futures market pricing for the GoC 10 Year bond, as at September 6th, 2016, as well as various other interest rate forecast scenarios, for comparison purposes.

Figure 1 - GoC 10 Year Interest Rate Scenarios



The Forward Rate for the GoC 10 Year[3], is an indicator of the collective interest rate expectations of all market participants. It is an interest rate curve based on the implied price investors are willing to pay for futures contracts for GOC 10 Year Bonds. This forward rate is materially lower than the SIRF through the rating period, with what can only be described as very significant variation in 2018 and beyond.

MPI rebuttal to the Evidence of Ms. Sherry

The Corporation offers the following comments in response to *Ms. Andrea Sherry's Note on Ratemaking in Accordance with Accepted Actuarial Practice in Canada and Impact of Investment (Discount) Rates*.

Ms. Sherry is correct that the current ratemaking methodology does not accord in all respects with Accepted Actuarial Practice (AAP). Many of the elements of the current ratemaking methodology do accord with AAP, but there are two main areas where it departs. These are discussed in *Volume III, AI.9 Actuarial Standards Compliance* of the GRA. The Corporation's current ratemaking methodology was developed over 20 years ago to ensure the breakeven mandate was achieved. The PUB has been applying that methodology ever since in setting Basic Autopac rates. The PUB has taken this approach with full knowledge that the methodology departs from AAP, and with an understanding of the reasons for the approach.

The Corporation has filed rates based on AAP for the past three years. This year's AAP-based rate calculations are included in *Volume III, AI.9 Actuarial Standards Compliance* of the GRA, thereby providing a basis for comparison between the results under current methodology and the results under AAP. The AAP based rate indication is a 5.8% overall increase, based on a 50/50 interest rate forecast. They would be 4.8% based on the SIRF.

MPI also notes that if it were to move to AAP rates, a revised definition of 'break even' may need to be developed. AAP-based rates are not based on net income (the

[3] Source: : Bloomberg CAD Sovereign Curve dated September 6, 2016

financial statement view), which has been the basis for an assessment of "break even" for many years. In *Volume III, AI.9 Actuarial Standards Compliance page 4*, the Corporation has shown that it can use AAP rates with a modified break-even definition, resulting in minimal differences to the overall major class rate indications between AAP and the current PUB approved methodology, with the one exception being motorcycles.

MPI remains cautiously receptive to transitioning to AAP based ratemaking, but notes there are issues that will need to be addressed as part of any transition. Generally speaking, the present ratemaking methodology was adopted by the Corporation and agreed to by the PUB, for specific reasons, and careful consideration is warranted to ensure that those reasons are no longer pertinent in the current context, and that any transition is in the best interest of Manitoba ratepayers.

The Corporation has stated its willingness to work with the PUB and stakeholders on this issue, and reiterates that willingness now. MPI believes that, in light of the significant considerations that must go into any transition to AAP, this is best addressed through collaboration that extends beyond this hearing.

MPI rebuttal to the joint evidence of Dr. Simpson and Ms. Sherry

MPI offers the following comments on the joint evidence of Dr. Simpson and Ms. Sherry entitled *Report on Use of the DCAT to Set the RSR Target Range*.

The report states at page 3, "the probability level associated with this methodology for setting the RSR maximum is unknown, illustrating its inconsistency with the methodology used for setting the RSR target". MPI disagrees that there is any inconsistency in the methodology used for setting the maximum RSR target.

In response to PUB (MPI) 1-24 MPI offered the following with respect to the MCT:

> "The MCT is used by OSFI (the Office of the Superintendent of Financial Institutions) and by all federally regulated property and casualty insurers in Canada. The information available to OSFI in the

development of the risk loads for the MCT is far greater than that available to MPI. The MCT also includes risk loads for items that are not easily quantified by the MPI DCAT, such as policy liability risk and operational risk. The MCT was selected for the upper target because it was an objective, externally developed, industry standard that could be used to appropriately benchmark the risks of MPI relative to the internal DCAT and to other insurers.”

Attachment A:

Excerpts of AutoPac Review Commission Position Paper No. 7 - Need for New Financial Policies and Improved Financial Management

AUTOPAC REVIEW COMMISSION

POSITION PAPER NO. 7

NEED FOR NEW FINANCIAL POLICIES AND IMPROVED FINANCIAL MANAGEMENT

Submitted to: Honourable Glen Cummings

Submitted by: Judge Robert Kopstein, Commissioner

Based on these options and observations, I find that reserves of between $30 and $60 million would be reasonable with a target level between $40 and $50 million.

Recommendation 7.11: That the government of Manitoba issue a public directive to the corporation setting an Autopac retained surplus target of about 15 percent of premiums. (This would amount to $40 to $50 million at prevailing premium levels.) The government directive should indicate that, if the Autopac surplus falls below ten percent or exceeds 20 percent of premiums, the corporation should and would be expected to take remedial action.

As I remarked above, the corporation budgeted for losses in 1986 in order to reduce surpluses. When losses occurred beyond those anticipated, the corporation's accumulated surpluses were suddenly eliminated in a single year. This is unacceptable. To prevent a recurrence, I suggest the following approach:

- When Autopac surpluses exceed target levels, the corporation should budget to break even; if a loss materializes then surpluses should be run down accordingly.

- When the corporation is operating below surplus target levels, offsetting rate increases should be phased in over a period of up to five years (depending upon the reserve deficit) in order to minimize rate shocks.

This approach will allow a more stable financial operation at Autopac.

Recommendation 7.12: That the corporation not budget deliberately for losses in any year, but budget for surpluses where reserves have been reduced below target levels, and that budgeting for surpluses should be such as to result in depleted reserves being returned to the target range over a period of not more than five years, depending on the degree of depletion.

D. INVESTMENTS

I adopt the findings of Deloitte Haskins & Sells with respect to MPIC investments:

> "[MPIC] is required under Section 12(1) The Manitoba Public Insurance Corporation Act to pay funds available for investment to the Minister of Finance. The types of long term investments in which the Minister of Finance may invest are set out under Section 19(1) of The Financial Administration Act and are, in summary, limited to:
>
> o Securities issued or guaranteed by the Federal Government, any provincial government, the Government of the United Kingdom and the Government of the United States of America.
>
> o Securities issued by any Manitoba government agency or corporation. . . .
>
> o Securities issued by Manitoba municipalities, schools or hospitals.
>
> o Guaranteed trust certificates issued by trust companies entitled to transact business in Manitoba.
>
> In addition, the corporation/Department of Finance have in practice the policy of investing wherever possible within the Province of Manitoba."

The actual values of invested assets since 1983 are displayed in Figure 7.6 according to whether they are in long-term or short-term investments. About 70 percent of assets are in MPIC's long-term portfolio, although this varies year by year. As indicated in Table 7.5, the corporation's total long term portfolio is entirely invested in fixed income securities, of which approximately 89 percent are invested in Manitoba and 37 percent are securities issued by Manitoba municipalities, schools or