Manitoba Public Insurance

2017 General Rate Application

Before the

MANITOBA PUBLIC UTILITIES BOARD

CLOSING ARGUMENT

of

Manitoba Public Insurance

November 4, 2016

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1.0 Introduction and Overview

1.1 Introduction

2 Over the past fifteen years, Manitoba Public Insurance's ("MPI" or the "Corporation") rates have consistently been among the lowest in the country for comparable coverage and service.[1] This is only the fourth time during that period that the Corporation has applied for an increase in Basic Autopac rates. MPI has requested a rate increase this year only after taking significant steps to control costs and transferring sufficient capital from the competitive lines ($148.2 million) to avoid the equivalent of a 19%[2] Rate Stabilization Reserve ("RSR") rebuilding fee. The track record of low and stable rates is a powerful demonstration that the current ratemaking framework has worked well for Manitobans. There is every reason to expect that it will continue to do so if the Corporation stays true to the principles of break even ratemaking and adequate capitalization.

3 The Board's rate setting mandate means that the Board has significant influence over fundamental elements of the Basic Autopac business, including: (i) how much revenue MPI collects (the rate), and (ii) how much of that revenue MPI can retain for mitigating risks, absorbing rate volatility, and investment (the RSR). The certainty MPI requires at present to operate the business and make investment decisions will come from:

a. re-affirmation of the longstanding focus of break even ratemaking based on net income;

b. using a best estimate interest rate forecast that does not result in systematic under collection of premiums and depletion of capital;

c. confirmation of the RSR definition;

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[1] MPI Exhibit 1, Overview, page 20
[2] T: 160, 13- 21

d. setting the RSR upper target of 100% MCT on more than a "notional" basis;

e. confirming a DCAT-based RSR lower limit, and

f. thereby establishing an RSR range with sufficient bandwidth to absorb losses from unexpected events. If the bandwidth is too narrow, rebates and rebuilding fees in quick succession could result in rate volatility.

4 Predictable and stable premium rates will ensure the ongoing success of the public auto insurance model in Manitoba. The orders sought in this application will promote rate stability.

5 The evidence and cross examination from interveners in this proceeding suggest the proverbial desire to "have one's cake and eat it too". They appear to simultaneously want the lower rates associated with relying on the SIRF, rate stability, the lowest possible RSR minimum that MPI's actuary can accept, the narrowest possible RSR band, and higher investment returns. The inherent inconsistencies in these objectives are self-evident:

a. Relying on the SIRF may bring lower rates today, but is short-sighted. Today's rates must be set based on best estimates of the costs of providing Basic Autopac. To set rates based on estimates that will produce significant losses is merely inviting higher rate increases and RSR rebuilding fees tomorrow.

b. Mr. Viola's whole thesis is that having rate stability as a primary goal is a "problem". Mr. Viola's approach of targeting long term returns, would require increased capital levels to manage the inevitable shorter-term volatility that results. While this may be a reasonable approach for a pension fund, it is not consistent with MPI's goals as a public auto insurer.

c. Rate stability also requires MPI to hold on to capital in order to absorb unexpected losses. Pressing for the bare minimum capitalization, and the narrowest possible RSR range, necessarily compromises MPI's ability to absorb losses and keep rates stable. Other public auto insurers, namely ICBC and SGI hold significantly more capital[3] than does MPI.

d. Obtaining higher short-term investment returns to reduce rates, which CMMG wants[4], means taking on more risk. Prudent investors assume only the risks they can afford. MPI has been in no position to consider a more aggressive investment strategy. Last year was the first year that the PUB did not establish RSR targets based on a percentage of premiums written, a metric unrelated to the risk faced by the Corporation.[5] The percentage of premiums methodology produced very low and narrow RSR thresholds which placed restrictions on the amount of investment risk that could be taken and still ensure that claims liabilities are paid. The PUB approved risk-based RSR thresholds last year, but the RSR minimum is currently set as low as MPI's actuary can (reluctantly) accept, the upper limit was only approved "notionally", and interveners continue to push for the RSR range to be narrower than is being requested today. Dr. Simpson and Ms. Sherry want to turn the lower RSR level into a target, and reduce the lower RSR tolerance to 1-in-10 years; meaning that MPI should expect to go insolvent once every decade, even with "management action" (e.g. rate increases). MPI will undertake a further ALM study only once these issues are resolved, but conducting further ALM studies will not change the Corporation's position that liability matching is appropriate and it cannot assume additional risk under the current circumstances.

[3] T: 230, 9 -22
[4] T: 904, 15- 20
[5] Order 128/15: page 76

6 MPI's evidence demonstrates that approving the proposed rates and other requested relief[6] will promote rate stability and support the longer-term financial health of the Corporation. It will position MPI well going forward. The proposals are just and reasonable and should be approved as sought.[7]

1.2 Overview

7 MPI provides an overview of its position below. These points are addressed in greater detail throughout the remaining sections of these Closing Submissions.

1.2.1 Break Even Ratemaking, Adequate Capitalization and Rate Stability

8 Section 2.0 Break Even Ratemaking, Adequate Capitalization and Rate Stability highlights the interrelationship between using best estimates, retaining adequate capital and rate stability.

9 Basic Autopac rates are set so that the forecast of net income over the two rating years (the year of the requested rate increase and the year after), averages out to zero. This is break even ratemaking. Staggered renewal dates mean that premium revenues from a given rate indication are collected over a two year window. MPI uses net income for rate setting purposes, and has made certain accounting elections that promote stability in net income. The Corporation's current year actuals do not directly impact the test years' forecasts. Current year forecasts that are better (worse) than budget will positively (negatively) impact the RSR in the following year's GRA.

10 The 1988 Report of the Autopac Review Commission (Kopstein Report) recognized that break even rates and adequate capitalization promote rate stability and protect the health of Basic Autopac.[8] In the same recommendations Judge Kopstein was clear that the Corporation needed to be self-sustaining. The PUB has consistently

[6] MPI Exhibit 1: Application, page 2
[7] CAC (MPI) 2-34, part e)
[8] T: 146, 20 - 25

acknowledged the importance of break even ratemaking and adequate capitalization.

11 The rationale for break even ratemaking and adequate capitalization remains as relevant today as it was thirty years ago. MPI needs to have its financial house in order as it navigates a period characterized by uncertainty in claims costs and investments and transitions towards what Mr. Guimond referred to as the "new normal".[9] In the current context, that continues to mean (i) Basic Autopac rates should be set in this proceeding using best estimates to target break even net income over the period covered by the Application; and (ii) Basic Autopac should be sufficiently capitalized to absorb volatility around the best estimates of investment income, interest rates and claims costs.

12 Rate stability is a cornerstone of the public auto insurance model, and is necessary for its continued success. MPI is unwavering in its commitment to rate stability – it is a positive attribute, not a "problem"[10] in need of fixing. Manitobans want comfort in knowing that from year to year, their insurance premiums will be about the same or, as CAA expressed it in closing submissions: Balanced stable rates are the standard that MPI should strive to achieve and uphold. If the Corporation cannot provide stable and predictable rates, it will lose the confidence and support of Manitobans. Approving the orders sought will affirm this approach, which has been the touchstone of public auto insurance in Manitoba for decades.

1.2.2 Cost Containment: Operating Costs Not Driving Rate Increase

13 Section 3.0 Cost Containment highlights that operating expenses are not contributing to the rate increase, and the proposed rates already reflect significant efforts by the Corporation to reduce operating costs and mitigate rate impacts. Cost containment is an enduring effort, as demonstrated by the $60 million in annual cost savings or avoidance identified in the 2015 GRA Value to Manitobans review. Last year, the PUB acknowledged MPI's efforts to reduce operating costs.

[9] MPI Exhibit 23: slide 87
[10] Mr. Viola's characterization as discussed in Section 7.4.1 Investments

Additional initiatives this year have identified $9.9 million in corporate budget reductions through the rating years. It is notable that savings are being derived from a variety of areas, with smaller individual initiative savings adding up to a material total. It is clear that "low hanging fruit" for cost savings have been picked, and MPI is digging deeper to find incremental budget reductions.

14 MPI compares favorably to industry on a variety of efficiency metrics, including Gross expense per policy in force at $286, compared to the Canadian Benchmark of $490.[11] MPI has also been pursuing staff reductions through attrition to contain operating costs, and anticipates realizing budget reductions through initiatives and an overall staffing strategy.

1.2.3 External Factors Driving the Rate Increase

15 Section 4.0 on Rates discusses the primary drivers of the rate increase, each are external to the Corporation.

16 The nature and extent of hail damage in Manitoba is changing. Comprehensive Claims were $52.7 million over budget in 2015/16, primarily due to increased hail claims. MPI has observed a persistent increase in the frequency and severity of hail storms in recent years, and as a result, the comprehensive claims forecast has been revised upward. As a result of worse than expected results in 2015/16, the 2017/18 forecast for annual Comprehensive claims cost was increased by $8.8 million.[12]

17 Lower forecasted investment income is also a significant driver of rates this year. The adoption of a best estimate interest rate forecast reduces the forecasted interest income from marketable bonds, and impacts the forecast of bond amortization. Both of these impacts are a direct consequence of the shift away from the SIRF.

1.2.4 Best Estimate Interest Rate Forecast

[11] MPI Exhibit 1: Overview, page 19
[12] MPI Exhibit 1: Voume I, INV., page 19

18 Section 5.0 demonstrates the appropriateness of using a best estimate interest rate forecast, whether that is done by way of an Interest Rate Forecast Risk Factor ("IRFRF") or just included in the overall rate indication.

19 The interest rate forecast is a key input in determining investment income and in valuing claims liabilities. The Standard Interest Rate Forecast ("SIRF") used to set rates has been consistently and materially overstated for a number of years. Dr. Cleary presented studies indicating that this upward bias dates back well before 2008.[13] Relying on an interest rate forecast that is expected to be too optimistic (high) produces a deficiency in the premium charged.

20 Once again, the SIRF is predicting a significant interest rate increase during the next three years. Relative to historical interest rate movements over 3 years, the forecast represents a 1-in-29 year interest rate movement.[14] While this level of movement is not impossible, there is ample evidence to conclude that the SIRF has had limited predictive power, and is not a best estimate.

21 Relying on the SIRF at this time presents significant risk to the Corporation. If interest rates stay flat, the Corporation will experience a $32.7 million loss to Basic Net Income. This loss alone, without accounting for any other cost pressures, would require a 5% rate increase (beyond the initially proposed 2%) just to break even on Basic Autopac premiums.

22 Dr. Cleary has recommended giving equal weight to the SIRF and naïve[15] forecast, and characterizes this "50/50 approach" as a best estimate. MPI has accepted this approach as a best estimate. Even with a best estimate, interest rate forecasting risk remains. Interest rates have declined in recent months, they could remain flat through the forecast period, or as the markets currently predict, rise less aggressively than the 50/50 forecast predicts. Risk remains with any forecast, but 50/50 reduces this risk on a forward looking basis.

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[13] T: 1619, 5 -1620, 24
[14] MPI Exhibit 6: slide 18
[15] Extrapolating the current interest rate in a flat line

1.2.5 RSR Purpose, RSR Minimum and Maximum

23 Section 6.0 Rate Stabilization Reserve explains how MPI has defined the RSR in a manner consistent with its historical use: to protect motorists from unexpected variances from forecasted results, and losses arising from non-recurring events and factors. This section also demonstrates the reasonableness of MPI's proposed Minimum and Maximum RSR targets.

24 As things stand, the lower RSR threshold determined through collaboration (1-in-40) is set at the minimum amount Mr. Johnston would sign-off on as providing a satisfactory financial condition.[16] At $159 million, it equates to approximately 26.2% MCT.[17]

25 Dr. Simpson and Ms. Sherry are pushing to go even lower, possibly as far as 1-in-10 year scenario after management action. That means MPI should expect to run out of Basic capital once every 10 years, even after rate increases. To put these numbers in perspective, OSFI would intervene if the capital of a federally regulated insurer fell below 150% MCT. The publicly owned Basic insurance providers in BC and Saskatchewan use 100% MCT as a regulatory minimum and target respectively, not a maximum. In the past two years, MPI has experienced the type of scenario upon which the RSR minimum was based, requiring transfers of $148.2 million to adequately capitalize Basic during that period.[18]

26 Last year, the PUB "notionally" approved an upper RSR threshold of 100% MCT. Any debate in this proceeding about whether MPI should be using MCT or DCAT scenarios to set the RSR maximum is obscuring the fundamental question: is it desirable to trigger a rebate if the resulting capital reduction will compromise MPI's ongoing ability to absorb unforeseen losses without a subsequent rebuilding fee? MPI submits that it is most consistent with stable and predictable ratemaking to maintain a sufficient RSR "band" such that the likelihood of a 'rebates and

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[16] T: 412, 12-17
[17] MPI Exhibit 17: page 21, 12 -13
[18] T: 160, 13-17

surcharges' scenario is kept to a minimum. This is consistent with Aon's recommendations.[19]

27 The risk of rate volatility is significant at present. Mr. Johnston referenced more frequent and severe weather events.[20] The capital markets are volatile.[21] The interest rate forecasts used in ratemaking have not materialized for several years in a row, leading to persistent and significant rate deficiencies. MPI exhausted capital in the competitive lines of business with the significant transfer to Basic Autopac in the past two years.

1.2.6 Investment Portfolio

28 Section 7.0 Investment Income explains the role of the Department of Finance in investing MPI's portfolio. It addresses the successful implementation of the Asset Liability Management (ALM) strategy on a corporate basis. It also explains the reasons why MPI's investment portfolio is appropriate in the current circumstances.

29 There is no disagreement that the investment portfolio should be optimized, and the Department of Finance actively manages the portfolio based on advice of investment experts. "Optimization" must be defined with respect to the objectives and circumstances of MPI, and not in the abstract. The primary objective of the investment portfolio is to pay claims liabilities. Managing the Corporation's exposure to interest rate changes on claims liabilities, an objective which has previously been endorsed by the Board, places a significant constraint on the portfolio. Growth is a secondary goal and MPI's investment strategy in recent years has reflected MPI's limited ability to absorb investment losses with low and narrow capitalization targets, and significant risk of a deficiency in rates.

30 CAC has presented evidence of Mr. Viola. He views an objective of short term rate stability to be a "problem", and sees MPI's 2014 asset liability study and investment approach to be "symptoms" of that "problem".[22] While Mr. Viola is obviously a very

[19] MPI Exhibit 43: slide 9
[20] T: 196, 5-12
[21] T: 263, 19-23
[22] T: 1893-1894

capable investment expert, he comes at the issue from a pension perspective that is fundamentally at odds with the way MPI has been regulated for decades. He offers no quantitative evidence that prioritizing long-term investment objectives over rate stability is better for MPI or Manitobans. MPI submits that it is not.

31 Some of Mr. Viola's specific recommendations are divorced from the practical realities of accounting standards, actuarial standards, and other practical constraints applicable to MPI. Some of Mr. Viola's other recommendations are very general "motherhood" statements, have already been reflected in the Aon study, are under consideration by MPI, or would have no material impact if implemented.

32 The focus on the ALM in this proceeding should not obscure the fact that investment managers and advisors are constantly working to improve the portfolio and respond to market conditions. There is value in undertaking an ALM study periodically, as MPI has done. There is also value in re-examining risk tolerances when circumstances change. However, the facts are that insufficient premiums resulting from the SIRF, and uncertainty around the RSR thresholds, have influenced MPI's views on investment risk. MPI's approach has been prudent in light of its circumstances. Approving MPI's requested proposals will position the Department of Finance and MPI to conduct another ALM study.

1.2.7 Benchmarking

33 Section 8.0 Benchmarking outlines how MPI continues to use benchmarking to enhance productivity and effectiveness, and that MPI continues to benchmark favourably on all three major macro-mandate-driven measures.

1.2.8 Information Technology

34 Section 9.0 addresses Information Technology ("IT"), which is not driving the requested rate increase. This section outlines the cost containment initiatives related to IT that have resulted in a reduction in licensing and software purchases,

reductions in IT spend due to contract negotiations and operational efficiencies that reduce data centre requirements.[23]

35 MPI has recently addressed technology obsolescence and continued investment is required to maintain IT assets.

36 MPI has appropriate governance and oversight mechanisms in place for IT. MPI has clear accountabilities and uses a Value Management Process to define the expected benefits, prioritize projects, and define the expected cost of new investments.

37 Gartner's CIO Scorecard, highlights that IT spend as a percentage of revenue is consistent with peers, particularly when accounting for the fact that MPI is not a for-profit business. Gartner's CIO Dashboard also reports that the Corporation compares well against the insurance benchmark group in many of the IT metrics and continues to improve on the others. Specifically, the Cost Containment measure has improved by nearly 50% since 2011, and exceeds the insurance benchmark. MPI's overall score has also improved since 2011, and exceeds benchmarks.[24]

1.2.9 Physical Damage Re-engineering

38 Section 10.0 Physical Damage Re-engineering (PDR) explains the importance of MPI's PDR initiative, and confirms MPI's commitment to adhere to best practices in the implementation of PDR.

39 MPI's PDR initiative is on track and on budget. Refinements and course corrections over the life of the program are both expected and desirable. MPI has the appropriate governance structures in place, and has taken steps to mitigate the program risks identified by Gartner.

[23] CAC(MPI) 1-36
[24] 2016 GRA: Volume I, Benchmarking Appendices Appendix AI.12-5, PDF page 64

40 Costs and benefits of the program are defined and achievable. Auditing and validation is built into systems to ensure benefits realization. Value management processes will ensure that the benefits can be tracked.

1.2.10 Road Safety and Loss Prevention

41 Section 11.0 addresses Loss Prevention and Road Safety. MPI's approach recognizes that a "safe systems" approach is suited to implementation in the context of the Provincial Road Safety Strategy, where all the stakeholders able to influence policy are present. Within that overarching framework, MPI has its own approach to evaluating, prioritizing and implementing initiatives. It involves consideration of claims cost impacts, but also the human toll of crashes. The latter consideration has been instrumental in elevating the priority given to vulnerable road users.

42 The evidence demonstrates that MPI's Loss Prevention and Road Safety investments are reasonable and that MPI is developing and executing programming in a manner consistent with best practice.

1.2.11 Other Matters – Accepted Actuarial Practice and Motorcycle Rates

43 Section 12.0 outlines MPI's position on ratemaking consistent with Accepted Actuarial Practice (AAP), and MPI's proposed one time only adjustment to motorcycle rates in light of the proposed adoption of the 50/50 interest rate forecast.

44 MPI's proposal to modify the approach to motorcycle ratemaking this year reflects unique circumstances. Namely, absent the proposed adjustment, motorcycle rates would increase by 8.8% this year, and would be highly likely to fall by about the same amount next year. This is contrary to MPI's objective of rate stability, and the requested adjustment is in the best interests of motorcyclists.

45 MPI's ratemaking methodology departs from Accepted Actuarial Practice in two respects, which are fully documented in the rate application.[25] MPI views that any departure from the currently approved rate setting practice needs to be done carefully and in a considered manner, recognizing the reasons for adopting the current approach over two decades ago.

[25] MPI Exhibit 1: Actuarial Standards Compliance, AI.9, page 2

2.0 Break even Ratemaking, Adequate Capitalization and Rate Stability

46 Break even ratemaking, as applied in the regulation of MPI for many years, means that rates are forecast to produce income approximately equaling expenses over the rating period. The principle manifests itself in the use of best estimates in ratemaking and having sufficient Basic capital reserves to absorb volatility around those best estimates. Break even ratemaking has been the standard because it promotes rate stability and maintains the financial health of the Corporation – both of which are in the long-term best interest of MPI and policyholders alike.

47 The principles of break even ratemaking and adequate capitalization would be challenged by following the PUB directive to use the SIRF this year when the evidence suggests it is not producing a best estimate. Using the SIRF would introduce significant and avoidable risk of deficient rates and losses. Acceding to intervener demands to narrow the RSR range would compound the risk by limiting MPI's ability to manage the inherent volatility of claims costs and investment returns. Converting the lower RSR level into a target, as Dr. Simpson and Ms. Sherry suggest, means even less capital. A lower RSR band to 1-in10 tolerance, as Dr. Simpson and Ms. Sherry advocate, is so low that Accepted Actuarial Practice precludes an actuary from preparing a DCAT on that basis. These specific issues are addressed later in Sections 6.2 and 6.2.1 of this Closing Argument. This section elaborates on the following points:

- First, break even ratemaking and adequate capitalization are reflected in the 1988 Report of the Autopac Review Commission (Kopstein Report) and subsequent PUB orders.

- Second, break even ratemaking has produced low and stable rates in past years.

- Third, MPI's current challenges makes it all the more important to adhere to break even ratemaking.

2.1 Long-Recognized Importance of Break Even Rates and Adequate Capitalization

48 The Kopstein Report emphasized, and many PUB Orders during the intervening three decades have recognized, the importance of break even ratemaking and adequate capitalization.

2.1.1 1988 Kopstein Report

49 MPI included the following excerpts from the Kopstein Report in its response to CAC (MPI) 2-34, which underscore the important role of rate and capital adequacy in the long-term health of Basic Autopac:

> *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.*

50 The Review Commission went on to make recommendations, including:

> *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.*

51 The Review Commission noted that "This approach will allow a more stable financial operation at Autopac."

2.1.2 PUB's Acknowledgement of Break Even Ratemaking

52 PUB orders since the Kopstein Report have given effect to break even ratemaking. In the past 16 years, the Board has in all but three of its rate application orders commented on rates being based upon the concept of revenue and costs breaking even. For instance, in 2000, Board Order 151/00 directed that:

In addition, future applications should be prepared based upon 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.

53 This requirement was repeated again in Board Order 148/04:

The Board agrees with MPI that, at minimum, Basic Insurance operations should achieve an annual break-even result. The Board has agreed in the past, and understands, that a break-even position would not necessarily result in a zero net income in any one year, given the uncertainty in forecasting costs and revenues.

54 These PUB orders implicitly recognize that MPI and its policyholders have a common interest in rate stability and the long-term health of Basic Autopac.

2.2 MPI's Rates Have Been Low and Stable

55 Break even ratemaking has produced low and stable rates. The following table shows MPI's past rate change history.[26]

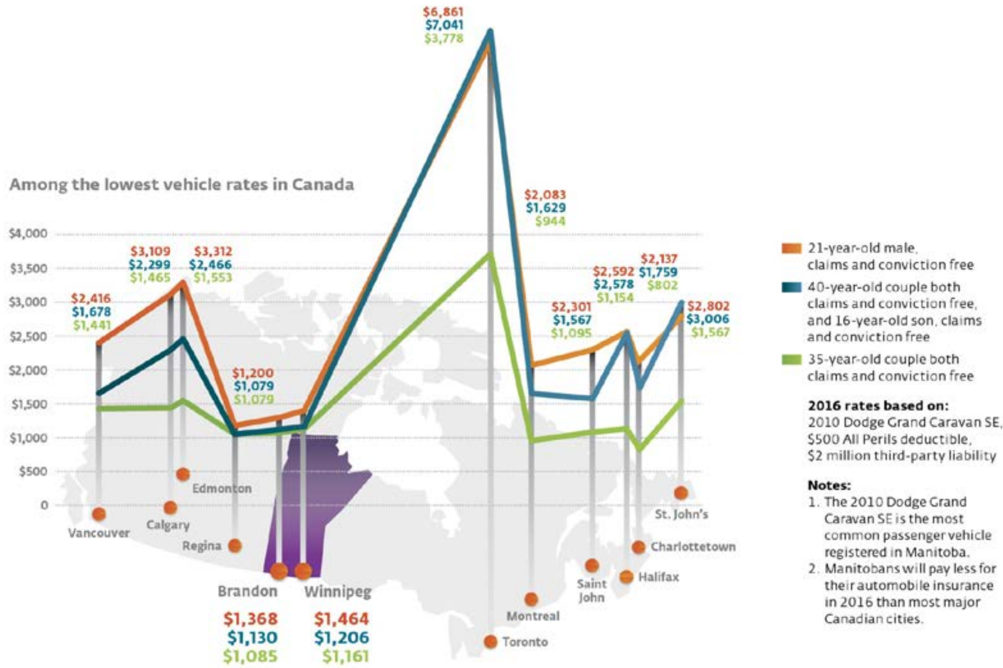
[26] MPI Exhibit 23: Slide 8

Year	Percent	Cumulative % Rate Change Approved (2001/02 Base)	Rebate $	Cumulative Rebate $
2016/17	0.0	-9.69%		$ 597,000,000
2015/16	+3.4	-9.69%		$ 597,000,000
2014/15	+0.9	-12.66%		$ 597,000,000
2013/14	0.0	-13.44%		$ 597,000,000
2012/13	-8.0	-13.44%		$ 597,000,000
2011/12	-4.0	-5.92%		$ 597,000,000
2010/11	0.0	-2.00%	$ 336,000,000	$ 597,000,000
2009/10	-1.0	-2.00%		$ 261,000,000
2008/09	0.0	-1.01%	$ 63,000,000	$ 261,000,000
2007/08	-2.6	-1.01%	$ 60,000,000	$ 198,000,000
2006/07	0.0	1.64%	$ 58,000,000	$ 138,000,000
2005/06	-1.0	1.64%		$ 80,000,000
2004/05	+3.7	2.66%		$ 80,000,000
2003/04	-1.0	-1.00%		$ 80,000,000
2002/03	0.0	0.00%	$ 80,000,000	$ 80,000,000
2001/02	0.0	0.00%		

56 MPI's rates compare very favorably to the rates in other Canadian jurisdictions, and will continue to do so with the proposed rate increase.[27] The following figure highlights Manitoba's favorable position.

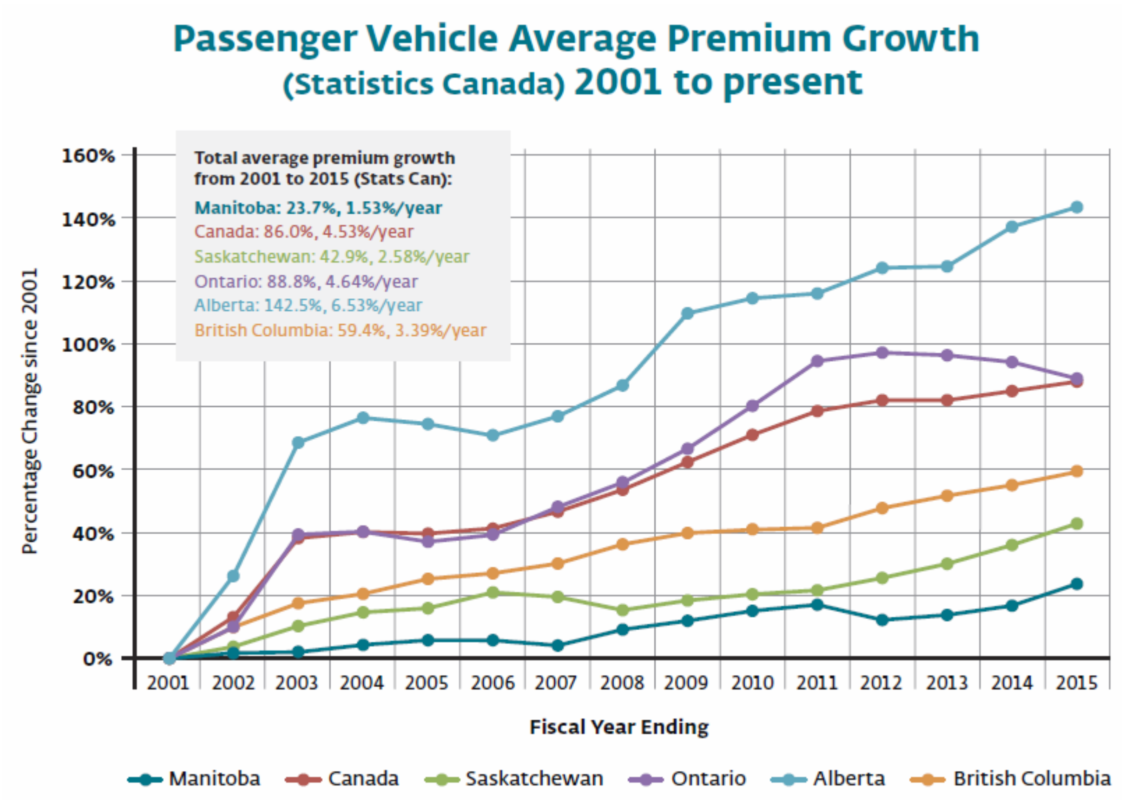
[27] MPI Exhibit 14: slide 17

November 4, 2016



57 MPI sees rate stability as a favourable objective and outcome, and not a “problem” (to use Mr. Viola’s words) that needs fixing. MPI is, first and foremost, a provider of an essential insurance product. Relative premium rate stability is a valued attribute of the product. The current approach of break even ratemaking has delivered both short term rate stability and low premium rates over a long period of time. The following chart shows that MPI premium growth rates are the lowest surveyed by Statistics Canada.

November 4, 2016



2.3 Rate Stability is an Appropriate Principle

58 Rate stability has been a core virtue of MPI premium rates for many years. One instance of PUB support for this approach is found in last year's Order[28]:

> *The Board has considered the arguments that a 1-in-40 probability level would result in excess reserves and intergenerational inequity, and has balanced these possibilities with rate-making principles, including the importance of rate stability.*

59 It comes as news to the Corporation in listening to the CAC's closing argument, that consumer interests have apparently pivoted away from a principle that previously enjoyed such broad acceptance.

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[28] Order 128/15: page 57

2.4 Positioning Basic Autopac to Meet Present Challenges

60 Rate adequacy and appropriate capitalization will position MPI to meet the current challenges facing Basic Autopac associated with investment volatility, uncertain claims costs, and automobile industry-driven changes. There are limits on MPI's willingness and ability to use the competitive lines to subsidize Basic Autopac.

2.4.1 MPI's Recent Losses and Ongoing Uncertainty

61 The Board has recognized that, at the best of times, forecasting net income and claims costs is challenging. It stated, for instance, in Order 135/14 (page 57):

> *The Board recognizes that the forecasting of net income is challenging, in particular the forecasting of claims incurred and investment income, both of which are subject to considerable uncertainty, in part due to interest rate sensitivity.*

62 The past few years have been exceptionally challenging in forecasting net income. The Corporation has faced significant losses year after year, and Basic capital reserves were depleted. As discussed in later sections of this Closing Argument, the losses have resulted from increased hail damage, interest rates being lower than forecast, and uncertainty in the capital markets. The losses experienced in the past two years alone would have required a 19% RSR rebuilding fee[29] but for two capital transfers. The uncertainty persists, making it all the more important to aim for rate and capital adequacy.

2.4.2 Transitioning Towards a "New Normal"

63 One of the themes that Mr. Guimond addressed in his opening presentation was that MPI is in the midst of a significant transition that brings with it significant uncertainty. The changes relate to the development of new vehicle technologies and the implications for auto insurance generally. In discussing the following

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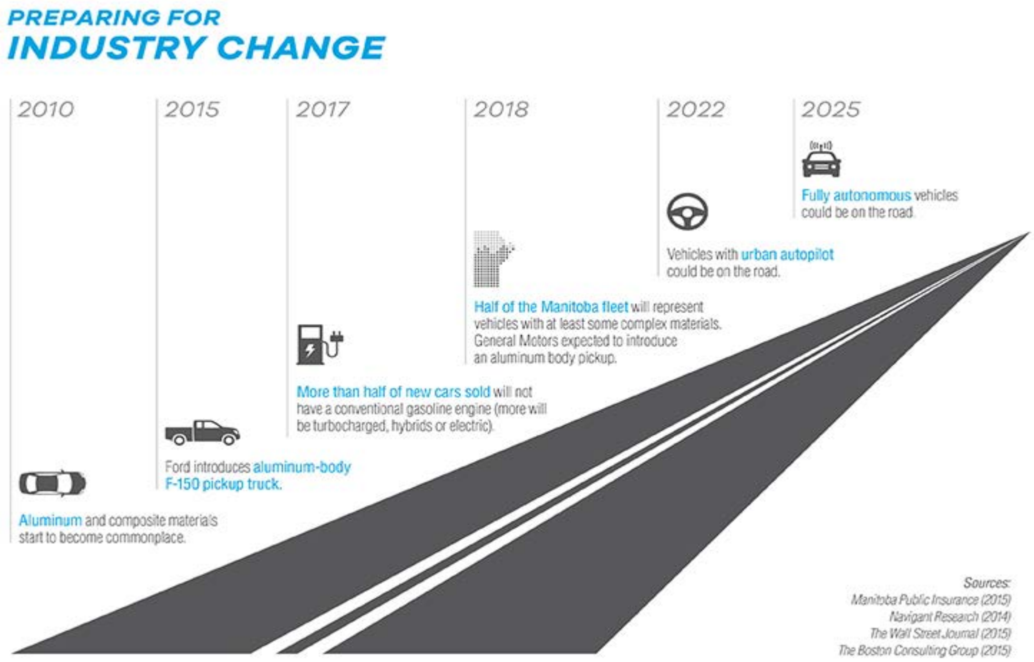
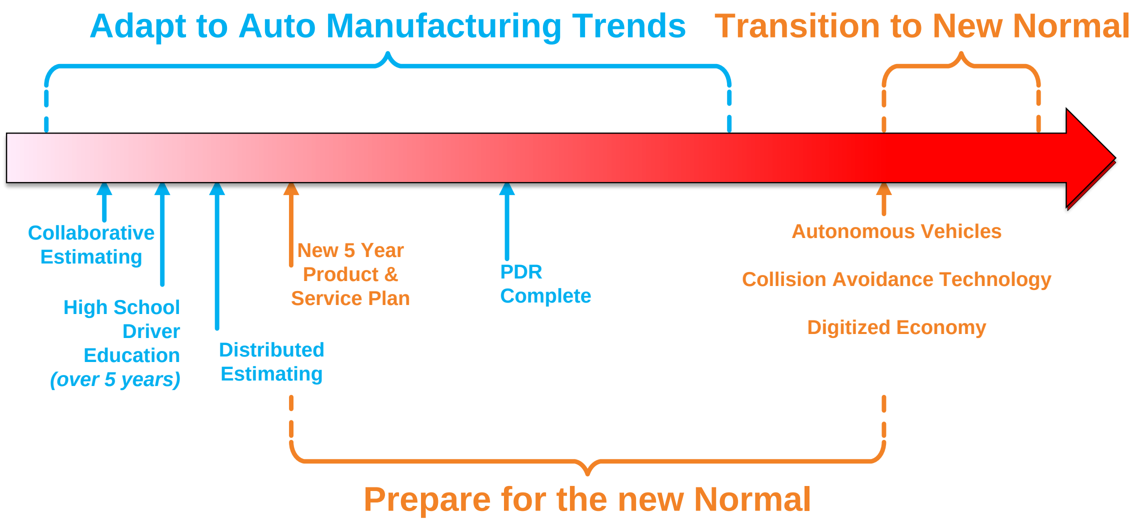
[29] T: 160, 17 -19

slide,[30] Mr. Guimond stressed that these technologies are already in play and can be expected to occupy a significant place in Manitoba within the next 10 years.



64 Mr. Guimond characterized MPI as transitioning to a "new normal". The transition is having implications for how MPI must provide service to customers. The PDR program, discussed in Section 10.0 is a key part of MPI's approach to address the "new normal". Mr. Guimond illustrated the interplay of PDR and the transition to the "new normal" with the following slide[31]:

[30] Exhibit MPI 14: slide 9
[31] Exhibit MPI 14: slide 10



2.4.3 Future Transfers Will Backstop Unanticipated Losses, Not Substitute for Break Even Rates

65 MPI has in the past two years, transferred a total of $148.2 million from the competitive lines of business to the Rate Stabilization Reserve[32] to meet the minimum RSR threshold and maintain the financial soundness of Basic Autopac. These significant transfers negated a 19% RSR Rebuilding Fee[33], but also significantly depleted the competitive lines reserves.

66 Consistent with break even ratemaking, transfers of this nature should be the exception. MPI's evidence is that it will consider future transfers of excess capital from the competitive lines to backstop unanticipated Basic losses, but not to address systemic deficiencies in Basic Autopac rates. This distinction is important in the context of interest rate forecasting. Mr. Guimond stated that he would not recommend transferring further funds to rectify a deficiency caused by relying on the SIRF in the face of evidence that it is not a best estimate. He explained that MPI management and the MPI Board of Directors owe their legal duties to the

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[32] T: 160, 13 -17
[33] T: 160, 17 -19

Corporation as a whole. Continuing to transfer funds to backstop rates that are set with the likelihood of being deficient is not a sustainable course of action:[34]

> *The MPI Board of Directors does have sole discretion to approve transfers, both the amount and timing that is given to them through the MPI CI (phonetic) [MPIC Act]. They much [sic – must] consider the current financial forecast at the time of the -- the transfer as well as what the rate indications might me [sic – be], or the overall financial condition of the Corporation among other things.*
>
> *So the MPI Executive Board of Directors also must be able to meet their financial responsibilities and ensure a capital reserve exists for the Corporation as a whole, to meet its statutory obligations. So hence transferring between lines of business, from Competitive to Basic to offset systemic deficiencies is not acceptable to the Corporation and its Board of Directors.*

67 MPI does not relish the prospect of seeking a significant RSR rebuilding fee, but the Corporation's position reflects good corporate governance and appropriate stewardship of public auto insurance in this province. As Mr. Guimond put it: "For me, this priority is about having the best estimate of breakeven net income and having adequate reserve in place to handle the volatility that we don't expect or can't predict. This is really key, from my perspective, to the ongoing success of Basic insurance."[35] Ms. Reichert shares Mr. Guimond's conviction:[36] "[B]reak-even net income helps to safeguard the financial health of Basic line of business, and the Corporation, and that helps to reduce the prospect of rate shock in future years and, we believe, would then help to maintain public confidence in Manitoba Public Insurance."

68 Both Messrs. Guimond and Johnston noted that, in light of the recent transfers of $148.2 million from the competitive lines, there is currently limited ability to transfer further funds. Mr. Guimond stated[37]:

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[34] T:163, 14 – 164, 4
[35] T:150, 4 -9
[36] T:182, 18-23
[37] T: 163, 14 – 164, 4

Fortunately, therefore, as of right now, there's not a shortfall in the Basic total equity RSR because of the transfers that we were able to make of the hundred and fifty (150) from the competitive lines. But because of those transfers from excess retained earnings in the competitive lines to Basic, we are now in the position where we have the limited ability to transfer further equity to subsidize Basic into the future.

69 Mr. Johnston echoed this comment, stating that “for the most part, we drained all excess capital from the competitive lines with the last transfer[38].

2.5 Concluding Remarks on the Role of Regulation as a Stabilizing Force

70 MPI faces significant uncertainty in its day-to-day operations from a variety of factors including claims volatility, capital market conditions, and industry changes. MPI respectfully submits that the regulation of MPI should be a stabilizing force, and not one that adds to uncertainty. The Board’s rate setting mandate means that the Board has significant influence over fundamental elements of the business – (i) how much revenue MPI collects, and (ii) how much of that revenue MPI can retain for mitigating risks and investment. The certainty MPI requires to operate the business and make investment decisions will come from consistent application of the break even rate principle, confirmation of the RSR definition, a realistic risk-based RSR lower limit, and an RSR upper limit set at a level sufficiently above the lower limit that customers do not face RSR rebuilding fees immediately after getting a rebate.

[38] T: 236, 9-11

November 4, 2016

3.0 Cost Containment: Operating Costs Not Driving Rate Increase

71 MPI's proposed rate increase already reflects significant efforts by MPI to reduce controllable costs, which are detailed primarily in the "Cost Containment" section of the Application. MPI's ongoing cost containment efforts have allowed the Corporation to absorb inflationary pressures. Operating expenses are not contributing to the proposed rate increase.[39]

72 In this section of the Closing Submission, MPI highlights the evidence demonstrating the following points:

- First, MPI has formalized its framework for identifying and realizing cost savings.
- Second, MPI's renewed focus on cost containment started in prior years, and achieved immediate successes, including significant savings last year.
- Third, MPI's Cost Containment Committee has been examining all areas of the Corporation for potential savings, and the savings it has achieved this year are material.
- Fourth, MPI's cost containment successes are appropriately accounted for, and have a favorable impact on MPI's performance against benchmarks, and the rate indication.

73 The evidence discussed below, none of which was acknowledged in intervener closing submissions, is a good illustration of sound management.

3.1 Continued Cost Containment Within a Formalized Framework

74 MPI has a track record of cost containment and delivering value. MPI's efforts continue today within a formalized framework.

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[39] MPI Exhibit 1: Volume II, Expenses, Exp. Page 3

75 In previous years MPI has undertaken major programs related to service enhancements, loss prevention, and IT initiatives that have resulted in cost savings or cost avoidance of approximately $60 million[40]. Details of these results were provided in the 2015 GRA Value to Manitobans Review.

76 MPI has formalized its cost containment approach in the Innovation and Cost Containment Committee (ICCC), established in 2014. The ICCC is comprised of directors and executive directors from throughout the Corporation[41]. They are ideally positioned to identify implementable cost saving initiatives, and to cultivate the culture of cost containment throughout the Corporation.

77 The ICCC meets approximately monthly[42], with the following objectives[43]:

- Ensure that Manitoba Public Insurance continues to investigate new and innovative ways of improving work processes, use of technology, new products and services in order to contain and reduce costs and deliver value to Manitobans.
- The Committee will identify, support, track and report on cost containment and cost savings initiatives. This will ensure that cost containment and reduction strategies are properly researched, vetted, and formalized.
- The Committee will utilize subject matter experts across the Corporation in order to further research and investigate the opportunities brought forward to, or initiated by, the Committee.
- New ideas generated by or through the Committee will be reviewed and approved by the Executive Committee or the Board of Directors, if required.

[40] MPI Exhibit 1: Volume I, OV.7, page 25
[41] T: 529, 1
[42] T: 528, 19-20
[43] MPI Exhibit 1: Volume 1, Cost Containment, pages 5-6

- Each idea will receive the appropriate amount of due diligence to ensure resources are not spent on initiatives that do not bring value to Manitobans.

78 As discussed next, the ICCC committee has delivered on these objectives in successive years since its formation.

3.2 Material Savings Last Year

79 Last year's GRA reflected an $8.5 million reduction in the 2015/16 corporate operating budget. The savings consisted of the following[44]:

2015/16 Budget Reduction Breakdown	$ in Millions
Compensation Other	2.8
30 FTE Reduction	1.5
External Labour/Data Processing/Hardware	1.3
Building	1.1
Furniture & Equipment	.4
Overtime	.4
Postage	.3
Depreciation	.2
Other	.5
Total	**8.5**

80 In Order 128/15 the PUB acknowledged MPI's efforts in containing costs at page 5:

[44] PUB Exhibit 14: page 1

The Board acknowledges the Corporation's cost containment efforts, including the elimination of some positions which contributed in large part to the $8.5 million in savings that the Corporation was able to achieve in 2015/16.

81 And further at page 16:

The Board's decision to approve the Application and order no overall rate change is driven by:

- MPI's advice that it did not seek a 1% rate increase in the Application because of the $8.5 million in cost savings that it has been and will be able to achieve in 2015/16, as well as its ongoing efforts in cost containment through Fiscal 2016 and beyond

82 The work of the ICCC has had a material impact on rates in past years. The ICCC's current efforts to reduce costs are described next.

3.3 Significant Additional Savings Identified in this GRA

83 MPI has identified an additional $8.0 million in estimated cost savings to the Basic line of insurance (or $10.0 million corporately) over the next two fiscal years. Ms. Reichert explained that these steps reduced the rate requested by approximately 0.5%.[45]

84 These savings are identified in the table below[46]:

[45] T: 167, 18-24
[46] MPI Exhibit 1: Volume I, Cost Containment, Attachment A, page 1

Basic-Estimated			
	2017/18	2018/19	2-Year Total
Cost Savings			
Pembina Service Center, staff reductions (80%)	-	260,000	260,000
Postage (70%)	560,000	560,000	1,120,000
IBM Data Center Operations, operational spend (80%)	1,296,000	1,253,000	2,549,000
Physical Damage Re-engineering, staff reductions (90%)	-	2,250,000	2,250,000
Staffing Strategy			
Reduction of 15 FTE (80%)	900,000	900,000	1,800,000
Total Basic savings identified	**2,756,000**	**5,223,000**	**7,979,000**

85 MPI discusses the source of these savings on pages 26 of the Overview of the Application. The sources include:

Pembina Service Center - attrition based staff reductions in 2018/19;

Postage - refining the use of certified mail;

Data Center Operations - operating model optimization and contract negotiations

Physical Damage Re-engineering (PDR) - attrition based staff reductions in 2018/19.

Staffing Strategy - 15 FTEs across the organization that can be eliminated through attrition

86 It is notable that the savings achieved in this GRA and the previous GRA are comprised of a wide variety of efficiencies that are not necessarily significant on their own, but add up on the whole. This is a clear indication that the "low hanging fruit" for cost savings have already been harvested. The incremental budget

reductions identified by the ICCC reflect careful, sustained attention by MPI to control costs.

3.4 MPI's Cost Containment Efforts Are Embedded in its Operations

87 The savings identified by the ICCC are implemented and tracked by managing actual expenditures to budget, as explained by Ms Reichert[47]:

> *MS. KATHLEEN MCCANDLESS: Thank you. How does the Corporation track the forecast targets against the actual achievements in cost savings?*
>
> *MS. HEATHER REICHERT: Essentially it is by managing to -- to the budget. So what we do is identify these savings, reflect them as reductions in the budget for the specific line items that are – are impacted, and then we monitor against that new reduced budget on -- on a monthly and -- and annual basis. So when the -- when the budget is achieved we've essentially saved the -- the money that we removed from the -- from the budget initially.*

88 The process of embedding the forecasted budget reductions directly into the budget establishes the new budget target on a prospective basis[48]. MPI manages operating expenses to the new budget target and tracks variances to those revised budgets on a line by line basis to identify positive and negative variances. Even if there are variances to the overall budget, the cost containment efforts can be tracked and reported on, as provided in *Volume I Cost Containment pages 6-8*.

89 The Corporation's staffing strategy, to reduce FTE's through attrition, is appropriately tracked and budgeted through the application of the vacancy allowance to the staffing budget[49]. This approach ensures that the Corporation only seeks recovery of costs for staffing that are reasonably anticipated to be incurred.[50,51]

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[47] T: 527, 21-528, 7
[48] T: 527, 21-528, 7
[49] T: 544, 2-7
[50] T: 539, 8-15

3.5 MPI Benchmarks Favorably on Key Efficiency Metrics

90 MPI's efforts in cost containment are reflected in the results of key efficiency benchmarks. MPI's gross expense per policy in force is almost half that of the Canadian benchmark. MPI's performance in terms of FTEs per 100,000 reported claims is outperforming the Canadian benchmark by more than double[52].

	MPI	CDN Benchmark
Gross expense per policy in force	$286	$490
FTEs per 100,000 Reported Claims	548	1281

91 Benchmarking is discussed further in section 8.0 of these Closing Submissions.

3.6 Concluding Remarks on Cost Containment

92 Operating expenses represent a small component of MPI's overall revenue requirement relative to claims costs (approximately 22%[53]), meaning that there are limits on the ability of MPI to reduce rates by cutting operating costs. Nevertheless, MPI's efforts have made a difference, as evidenced by the fact that operating costs are not contributing to the proposed rate increase. The Innovation and Cost Containment Committee will continue to investigate, identify and implement operating cost reduction initiatives.[54]

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[51] T: 547, 20-548, 3
[52] MPI Exhibit 23: slide 87
[53] Based on rating period average of Total Basic Operating expense (the sum of Claims Handling, Loss Prevention, Operating, and Regulatory) over Total Earned revenues. See PUB(MPI)2-25 Pro Formas
[54] T: 167-168

4.0 External Factors Driving the Rate Increase

93 This section addresses the key drivers of the requested rate increase. The two largest drivers of the requested rate increase are:

Changes in the Comprehensive Claims forecast –caused mainly by a significant increase in hail claims counts and hail severity in 2015/16

Changes in the Investment Income forecast – caused mainly due to reductions in forecasted interest income and bond amortization from lower interest rates in 2015/16 and a lower interest rate forecast using the 50/50 method

94 The source of these impacts is outside the control of MPI. MPI's requested rate increase reflects the Corporation's current best estimates for all forecasts.

95 In this Section, MPI makes the following main points:

- First, MPI employs standard forecasting and modeling techniques in deriving best estimates for all of its forecasts;
- Second, deteriorating hail experience in recent years continues to drive the comprehensive claims forecasts upwards, which is one of the main drivers of the rate increase;
- Third, continued low interest rates, underperformance of the SIRF, and the change to the revised 50/50 best estimate interest rate forecast are the other main driver of the rate increase;
- Fourth, the remainder of the rate indication consists of a series of smaller changes to the forecasts relative to last year, grouped as "other".

4.1 How Forecasts Affect Rates

96 In this section, MPI recaps in a general and simplified way how the Corporation prepares forecasts, and how the change between this year's and last year's forecasts impact the rate indication.

97 Each year, the Corporation prepares a best estimate forecast of premium and fee revenues, claims costs, expenses, and investment income. This exercise is done at a very granular level utilizing experts from the applicable areas of the Corporation. These detailed forecasts are included in Volume II of the Rate Application.

98 These forecasts are then input into a financial model, which produces pro forma financial statements for the Corporation's five year forecast period. These forecasts are then used to determine the change in revenue required to achieve break even net income over the GRA rating period. For the 2017 GRA, the rating period is the average of the 2017/18 and 2018/19 fiscal years, or the period in which the 2017 policies are in force. The percentage change in revenue required to break even over the rating period is what the Corporation's applies for in the GRA.

99 There is inherent uncertainty in all forecasting. However, some forecasts are more uncertain than others. For example, the forecast for premium revenue is very stable because of the Basic monopoly and the consistent nature of annual population growth. However, the forecast for hail claims is highly uncertain because of the unpredictable nature of large hail storms.[55] In each GRA, the Corporation updates its forecasts assumptions and models based on the latest information in order to produce a best estimate forecast. To the extent that these forecasts change relative to prior year's forecasts, there may be revisions to the Corporation's expected net income and break even rate indication.

a. If undiscounted claims costs or expense trends change (e.g. there is higher than expected growth in the frequency and severity of hail claims) then that will impact the forecast and the rate indication. All

[55] T: 196, 5-12

else equal, MPI will need more/less premium revenue to make up for a change in the claims or expense forecast.

b. If investment assumptions change (e.g. actual and forecasted interest rates are lower than expected) then this change will impact the investment income forecast (and potentially the discounted claims incurred) and the rate indication. MPI will require more/less premium to offset the change in the investment income forecast.

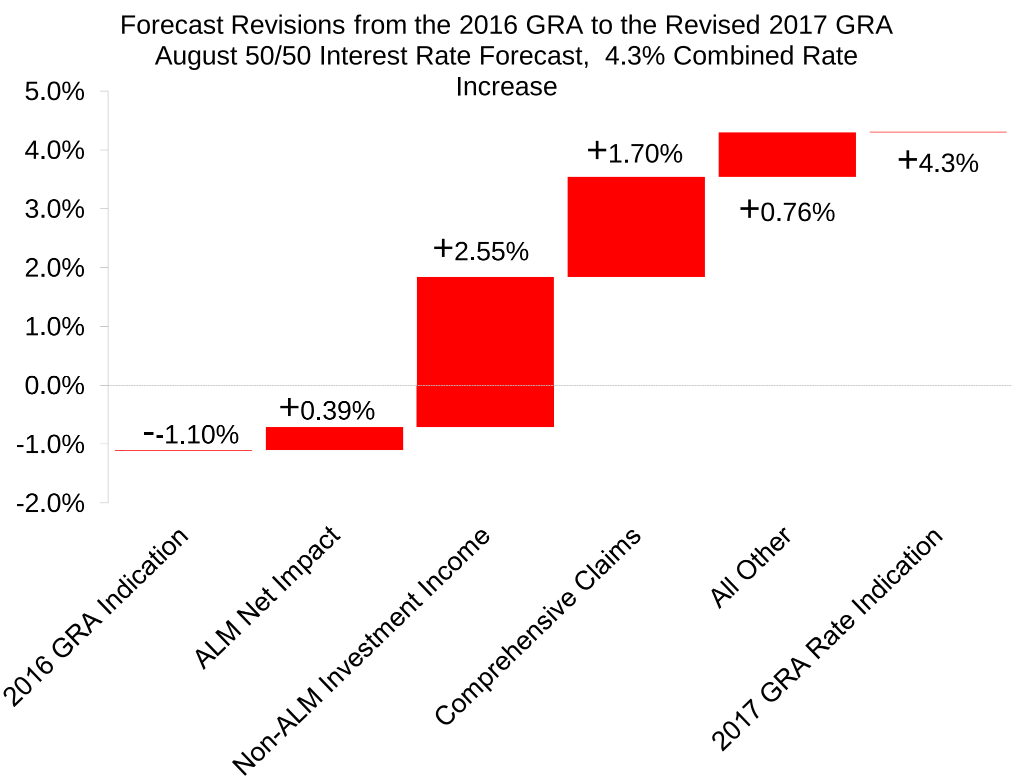
c. If premium trends change (e.g. growth in the fleet is lower than anticipated) then this change will impact the premium forecast and the rate indication. MPI will require more/less revenue to offset the change in the premium forecast.

100 The forecast of interest rates is one of the most important factors in the development of the rate indication. Due to the significant amount of claim liabilities and fixed income assets held by the Corporation, changes in interest rates can have a significant impact on the forecast.[56] Interest rate forecasts determine the discount rate used for claims liabilities; with higher discount rates causing a reduction in the value of claims liabilities. Interest rates also affect investment income; with higher interest rates causing losses on the Corporation's fixed income portfolio. The Corporation has an Asset and Liability Management (ALM) program that attempts to offset the impact of interest rate changes on claims and fixed income assets by matching the dollar value and duration of these cash flows. However, the claims liabilities and fixed income assets are not perfectly matched on Basic, the net effect being that claims impacts are greater than fixed income impacts for a given change in interest rates. Forecasting an interest rate increase has the net effect of reducing rates, other things being equal.[57]

101 This year, there was a change in the SIRF forecast from last year that unfavourably impacts the rate indication. In addition, MPI is proposing a change to the interest rate forecasting methodology (the 50/50 approach).

[56] MPI Exhibit 1: Volume II, INV. 1.2
[57] T: 600, 16-24; 602, 16 - 603, 6

102 Last year, MPI had forecast a -1.1% rate decrease for the 2017/18 rates. However, as a result of the revised best estimate forecasts, the revised rate indication is 4.3%, or a swing of more than 5.4% in absolute terms. The following 'waterfall' chart summarizes the key components that caused the change in the 2017/18 rate indication between this year's and last year's forecast[58]:



103 Mr. Johnston explained the chart as follows[59]:

> *MR LUKE JOHNSTON: This table is saying last -- last year when we came to this hearing we would have predicted that '17/'18 rates would have had a 1.1 percent rate decrease. And there's some items that caused that forecast to change, and now we're up to four point three (4.3)... So those - you start at negative 1.1, and you add up those numbers, that gets you to the 4.3, so basically a 5 percent swing in rate.*

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[58] MPI Exhibit 23: slide 31
[59] T: 194, 24 - 195, 4 and 9-11

104 These changes in the forecast which drive this increase are discussed in greater detail below.

4.2 Losses Due to Hail are Driving Comprehensive Severity Growth

105 Comprehensive claims forecast is driving a $12.1 million reduction in net income, or 1.70% increase in rates as a result of higher than expected hail claims counts and overall higher comprehensive severity growth rates in the 2015/16 year, impacting the forecast going forward.

4.2.1 New Pattern of Hail Claims

106 Recent experience with hail has differed materially from historic periods.

107 Mr. Johnston explained that, over the last five years, Manitoba has experienced significantly more net hail losses (i.e. losses after reinsurance) than in previous periods. It has become clear that the hail pattern is changing as there has been an increased incidence of smaller, non-reinsured hail events. Last year was particularly severe. Comprehensive claims incurred was $52.7 million over budget in 2015/16. The 2015/16 accident year resulted in the highest comprehensive frequency since the 2007/08 year, and was caused mainly by a poor hail year.[60] The severity growth rate for hail claims, which increased by 12.18% in 2015/16, also reflected an increase severity of storm damage relative to previous years.[61] Although one year of experience does not normally cause significant changes to the claims forecast, the magnitude of the events in 2015/16 resulted in the Corporation increasing the 2017/18 Comprehensive forecast by 13.9%, or $10.9M, higher than last year's forecast.[62]

108 Mr. Johnson explained the new pattern he is seeing[63]:

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[60] MPI Exhibit 1: Volume II, CI, page 40
[61] MPI Exhibit 1: Volume II, CI, page 43
[62] MPI Exhibit 1: Volume II, CI, page 45
[63] T: 196, 5-23

MR. LUKE JOHNSTON: The other big impact is comprehensive claims. It was a very difficult year for hail last year, and really for the last five (5) years or so. There has been speculation that, you know, it's climate change related or -- or whatever. We've talked to re-insurers. They've said the frequency of storms seems to be increasing, and -- and other insurers are saying the same thing. What's happening with MPI is we have re-insurance coverage for any single storm over 15 million, but that -- we're not getting storms over 15 million. We're getting hit with a whole bunch of small storms, which is -- is very unique. It's not -- to the last I guess five (5) years. So we've been struggling with this forecast. Last year we were -- it says hail claims are -- were 52 million over budget. It should say comp. But hail, water, flood, all those related perils are essentially driving this change.

109 Mr. Johnson further explained[64]:

MR. LUKE JOHNSTON: Okay, I touched on this briefly yesterday. But what we're struggling with on hail right now is our old -- in our old forecast of hail we used to very much have a big storm or almost nothing. I remember a time when we used to budget 5, $6 million of net hail experience, so after -- net being after reinsurers pay -- pay us any -- any money.

And that continued for ma -- our whole history, essentially, until the last five (5) to six (6) years where the frequency of hail has increased, and so a lot more small hail storms, which is obviously not -- we're not collecting anything from reinsurers for these small storms. So when that first started happening it was difficult for us to decide if this was an outlier or if this would continue, but it basically has continued to persist. And our hail forecast has followed along, increasing from under 10 million to --into the 20 millions today.

4.2.2 Loss Experience Impacts Comprehensive Ultimate Forecast

[64] T: 319, 12 - 320, 6

110 Faced with this unusual experience of many small hail storms that do not qualify for re-insurance coverage currently held by MPI, alternatives are being explored for cost effective options to protect Manitobans. However, MPI cannot bank on the availability of re-insurance at a reasonable cost. All indications are that it would be difficult to obtain. Mr. Johnston noted: "Historically, that coverage has been very expensive or providers haven't wanted to even offer it to us."[65]

4.3 Lower Forecasted Investment Income – ALM and Non-ALM Impacts

111 The single largest component of the requested rate increase relates to the investment income forecast. A $10.2 million reduction in interest income and an $8.9 million impact due to bond amortization is driving 2.55% of the required rate increase.[66]

112 Impacts to the investment income forecast is the result of the absolute level of interest rates being forecasted to be lower under the best estimate 50/50 interest rate forecast. By reducing the interest rate forecast, the forecasted interest income from marketable bonds is reduced. The reduction in the interest rate forecast also impacts the forecast of the accounting treatment of bond premium/discount, known as bond amortization.[67] These combined effects are the 'non-ALM' impact of the adoption of a best estimate interest rate forecast.

113 The ALM related impacts of the best estimate interest rate forecast account for 0.39% of the overall proposed rate change from the 2016 GRA. This is the net result of changes in interest rates to the value of the fixed income portfolio and claims liabilities. The net impact from the Asset and Liability Management (ALM) program relative to last year's forecast was a $2.8M reduction in net income.[68]

4.4 All Other Impacts

[65] T: 322, 18-20
[66] MPI Exhibit 23: slide 32
[67] MPI Exhibit 23: slide 32
[68] MPI Exhibit 23: slide 32

114 A number of smaller components comprise the "All Other Impact" component, which accounts for 0.76% of the difference in the required rate increase from last year's GRA to the present GRA. The components include minor changes (i.e. less than $2 million each) in the premium forecast, the expense forecast, and the investment income forecast for equities and alternatives.

115 The lower premium forecast of $1.7 million (before application of the rate change) was caused by lower than expected volume and population in the 2015/16 year.

116 The higher expense forecast, amounting to $1.5 million, stems from claims incurred being the primary allocator of expenses. The move to a best estimate interest rate forecast has the effect of changing the allocation of expenses very slightly, which results in the minor change to the expense forecast.

117 Deterioration in investment income from equities and alternatives[69] has a similarly small impact of $1.4 million on net income.[70] Underwriting losses have been compounded by a deterioration in forecasted investment income from equities as a result of the financial market downturn in 2015/16.

118 Finally, a combination of small impacts to all other revenue, claims, expense and investment income forecasts result in a forecast decrease in net income of $0.5 million.

[69] T: 177, 13-21
[70] MPI Exhibit 23: slide 34

5.0 Best Estimate Interest Rate Forecast

119 Forecasting an interest rate increase has the effect of reducing claims expense, with only a partial offset in terms of the loss on bond valuation.[71] More than half of the proposed rate increase (2.3%) is attributable to the recognition that interest rates are unlikely to increase as much over the rating period as the SIRF predicts. Mr. Guimond characterized the need to address the risk created by the interest rate forecast as “imperative to MPI”.[72] Adopting a best estimate interest rate forecast based on a 50/50 percent weighting of the SIRF and the naïve forecast (“50/50 approach”) reduces the risk of a significant rate deficiency and an RSR rebuilding fee in subsequent years. MPI has sought to give effect to the best estimate by way of the IRFRF so as to respect the PUB’s previous GRA Order, but the 50/50 interest rate forecast can be implemented as part of an overall 4.3% increase.

120 MPI elaborates on the following points in this section:

- First, it is well-established that rates should reflect a best estimate of interest rates.

- Second, the evidence points to a 50/50 approach being a best estimate of interest rates.

- Third, the SIRF is not a best estimate of interest rates given the available information.

- Fourth, there are significant favorable implications for the financial health of Basic Autopac and rate stability from using a best estimate, and rejecting the SIRF.

- Fifth, the risk created by relying on optimistic interest rate forecasts will not be resolved by altering the inputs to the SIRF.

[71] T: 600, 16-24; 602, 16-25 -603,1-6
[72] T: 160, 6-10

- Sixth, MPI should be permitted to put forward, and defend, the forecast it considers to be a best estimate.

- Seventh, MPI's request for an IRFRF was an appropriate response to unique circumstances, and the collaborative process was a worthwhile exercise.

- Eighth, Dr. Simpson's evidence on interest rates is flawed in several respects.

5.1 Propriety of Using Best Estimates of Interest Rates is Well Established

121 The PUB's practice has been to set Basic Autopac rates based on what it has determined to be a best estimate of interest rates. The Board's 2014 Decision stated[73]:

> *MPI continues to hold the view that the Low Growth Rate Forecasting Methodology should be utilized, though the forecasts within the Application were not prepared on that basis. The Corporation acknowledged that it does not have expertise in interest rate forecasting but stated that it has an in-depth understanding of the interest rate risks which it faces.* ***The Corporation acknowledges that the GRA must be prepared on a best estimate basis.***
>
> [Emphasis added.]

122 The Board then rejected MPI's approach to forecasting interest rates based on the Board's assessment that MPI's estimate was not a best estimate[74]:

> *The Board agrees with CAC that the Board should consider the most recent interest rate information available for rate-setting purposes, and as such the Board accepts the forecasts for Basic that include the updated October 2014 interest rate forecast.* ***It is the view of the Board that the standard interest rate forecast prepared by the 5 major Banks and Global Insight***

[73] Order 135/14: page 40
[74] Order 135/14: page 44

is the best information that is available with respect to interest rate forecasts, other than longer term forecasts available for purchase, which MPI has not done.

MPI has stated that is has no expertise in interest rate forecasting, and has submitted no evidence to support the submission that the Low Growth Rate Forecasting Methodology represents a best estimate and should be accepted. As such, the Board is not in a position to accept the Low Growth Rate Forecasting Methodology.

[Emphasis added]

123 In an earlier decision, Order No. 151/13, the Board similarly stated[75]:

With respect to interest rate forecasting methodology, the Board is of the view that it has insufficient evidence upon which to make a decision. The Board has reviewed the option that MPI put forward, including MPI Exhibit 8 which reflects its predictions with respect to interest rate activity, ***but the Board has heard no expert evidence with respect to interest rate forecasts*** *as it did in the Centra Gas and Hydro hearings prior to making a decision with respect to interest rate forecasting methodology.*

[Emphasis added]

124 These quotations highlight that the PUB's decisions to use the SIRF was influenced by shortcomings it had identified in the evidence presented by MPI. Any evidentiary gaps that had existed in prior years have now been filled. The evidence before this Panel, discussed next, confirms that the 50/50 approach yields a best estimate and precludes reliance on the SIRF.

5.2 Dr. Cleary: the 50/50 Approach Is a Best Estimate

125 MPI's adoption of the 50/50 approach is informed by Dr. Cleary's recommendation, which is in turn informed by empirical evidence of past performance and Dr. Cleary's assessment of capital market conditions.

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[75] Order 151/13: page 32

126 Dr. Cleary explained his recommendation as follows[76]:

> *So if we take a look at the evidence that I've provided, and we look at the SIRF and the average error minus 1.7 percent, or a forecasting error of minus 93 percent, the Naïve, much lower.*
>
> *And in the 50/50, somewhere, I think, halfway in between, the obvious question is: Why am I not advocating a Naïve approach, here, because it seems to have done better? And I suggest that a 50/50 approach is most likely to minimize the error, which, I think, to me is what the definition as best forecast is, if you can minimize the forecasting error.*
>
> *And I think a 50/50 in the long run will reflect the fact that interest rates may increase soon, and would be forecasted – these would be included in the economic forecasts, but that it may not happen as quickly as possible – or sorry, as anticipated.*
>
> *And the evidence shows that even directionally, the economists have not done a good job, not only in terms of forecasting the absolute level , but even which direction it's going to go. They have a poor record of forecasting the direction.*
>
> *So by establishing a starting point where we are today as one of your limits, I believe that will minimize forecasting errors and –and I've put here, the chance of being way off.*

127 Dr. Cleary's key point is logical: one has less of a chance of being wrong if some weight is given to the position of interest rates today.

128 PUB Counsel asked MPI whether the selection of 50/50 was arbitrary. It is no more or less "arbitrary" than the SIRF itself. Dr. Cleary has exercised his professional judgment in recommending the 50/50 approach, considering the empirical evidence discussed below his expert understanding of the capital market conditions. He reached a different conclusion from the institutions whose forecasts are reflected in

[76] T: 1626, 18-1627, 20

the SIRF. The objective evidence supports Dr. Cleary's view that the 50/50 approach yields a best estimate[77] in the circumstances.

5.3 Compelling Evidence that SIRF is Not a Best Estimate

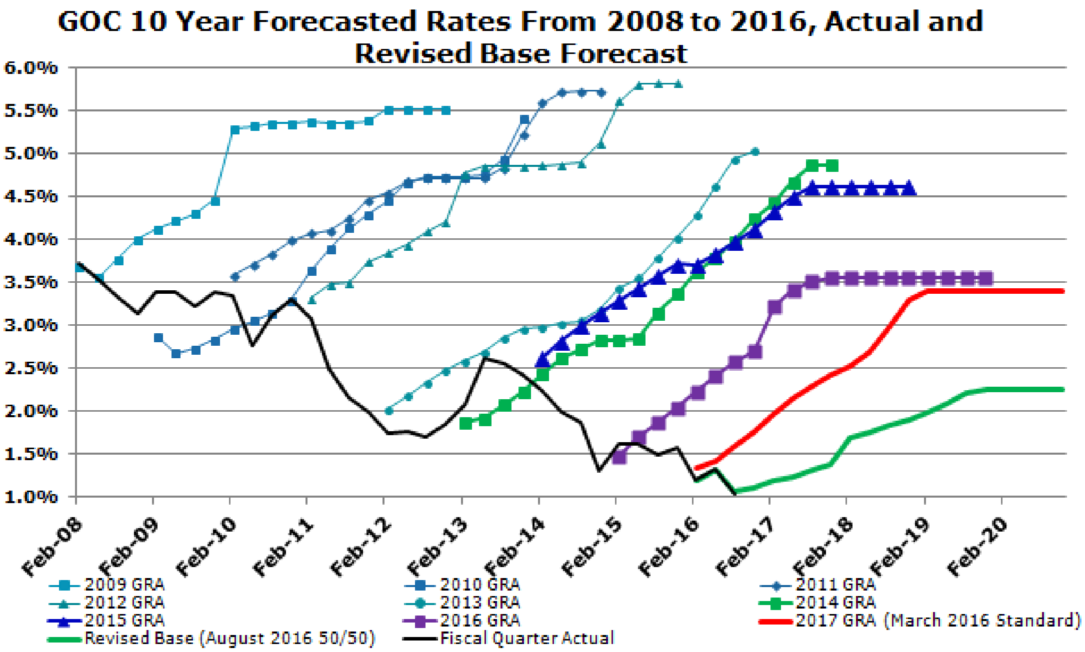
129 There is compelling evidence before this Board Panel, much of which was not available to previous Panels, that the SIRF is overstating interest rate movement in the next two years by a wide margin. That evidence is summarized below.

5.3.1 Another Year, Even Worse Performance

130 The unfavourable track record of the SIRF in predicting interest rate movement has persisted since the PUB's previous decisions. We have reached a point where the SIRF's poor track record must be recognized in the determination of a best estimate.

131 MPI provided the following figure in the Application depicting the extent to which the SIRF has consistently exceeded the actual interest rates.[78] The forecasts have been off by a wide margin, and have even been directionally wrong in most cases.[79]

[77] T: 1629, 10-13
[78] MPI Exhibit 1: Volume II, INV. Page 17, Chart 1.2.2
[79] MPI Exhibit 23: Slide 11



132 MPI retained Dr. Cleary to provide additional expert perspective on the performance of the SIRF and to provide his opinion on a best estimate interest rate forecast. Dr. Cleary summarized the SIRF's poor performance as follows in his Report[80]:

> *Using interest rate forecasts that are too high by an average of 1.72% in absolute interest rate terms represents a significant issue from any perspective, especially when such estimates are used for product pricing purposes. However, the 1.72% difference from actual estimates represents even worse forecasting ability if we scale the error terms by the actual realized yields to obtain an idea of what percentage these estimates were off the mark. Table 3 below presents the results obtained when I express the forecast error (i.e., "actual – forecast") as a percentage of the actual rates, which is one standard way of measuring forecasting ability. Table 3 shows that the average percentage forecast error resulting from the GRA forecasts ranged from -27.2% for the 2016 GRA to -144.9% for the 2012 GRA, with an overall weighted average of -92.9%. In other words, the resulting GRA forecast averages were almost double (i.e., which would correspond to a -100% percentage forecast error) the actual yields that prevailed over the period! Clearly, these forecasts were not very*

[80] MPI Exhibit 8: page 6

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informative at all. In fact, it would have been much better to use the prevailing rates at the times of the GRAs and assumed no change, as I will show later.

133 Interest rates have again declined in recent months, only reinforcing this trend of SIRF poor forecasting performance.[81]

5.3.2 Dr. Cleary: SIRF at Odds with Current Market Conditions

134 The SIRF and Olympic-style forecasts directed by the PUB are contemplating steep increases in interest rates within a short period of time. The movement contemplated in the SIRF represents a 1 in 29 year event, predicting increases that would erase all of the declines since the 2008 financial crisis in the space of two years. The Olympic-style forecasts represent a 1 in 119 year event – even the DCAT adverse scenarios used for financial stress testing (at 1 in 40) are much more likely to occur. Dr. Cleary's evidence regarding the current financial market conditions – information not previously available to the PUB - demonstrates that these forecasts are *very* optimistic.

135 Dr. Cleary identified that the outcome of central bank policies continue to have impacts on the capital markets and suggest a low interest rate climate persisting in the near term[82]:

Several factors have led to a decline in interest rates over this period, rather than the previously projected increases. These include but are not limited to: the Euro banking crisis and continuing struggles in the Eurozone; slower than anticipated recovery of the U.S. economy; ongoing struggles for the Japanese economy; and, various global events. As a result of these and other events, while the U.S. Federal Reserve ceased their bond buying program, they have not yet begun to "unwind" their significant bond holdings of over 3.5 trillion USD. Neither has the U.K., which holds approximately 0.5 trillion USD. In addition, Japan began purchasing approximately 660 billion USD in bonds per

[81] CAC (MPI) 2-42
[82] MPI Exhibit 8: page 18

year in 2014, while the European Central Bank (ECB) also initiated quantitative easing at a rate of 60 billion Euros per month in January of 2015, which they increased to approximately 80 billion Euros in March 2016. The result of these policies is that somewhere in the area of $6 trillion USD in bonds held by monetary authorities at the present time. Obviously, this has kept bond yields very low, and in fact we are all aware of the massive amount of government debt presently trading at negative yields.

Given this severe overhang, it seems unlikely that interest rates on AAA-rated Canada 10-year bonds are likely to rise rapidly from the existing level of about 1%. Forecasts predicting rapid increases in 10-year yields to historical levels above 3% and even 4% are surely overly optimistic, since much has to happen before we will see such upward pressures on 10-year yields. This is unlikely to happen over the next year or two, and I would say is also very unlikely to happen over the next three years; although I would acknowledge that yields will eventually start to increase gradually.

136 Dr. Cleary spoke in greater detail about the current market conditions during the hearing. He stated, for instance[83]:

And I think most people would agree that interest rates are going to go up. On the other hand, there's a lot of things that are keeping interest rates down. One of the main things that everybody talks about is the quantitative easing programs initiated by several central banks, the US of course being the first, followed more recently by the European Central Bank, and Japan, which have begun doing so aggressively. The UK followed the US earlier, cease their program of buying bonds for a while to keep interest rates low, recently resumed it at a smaller scale, they haven't started putting – I guess the bottom lines is US has stopped buying these bonds, but they haven't started selling them back to – until they start selling them back interest rates are going to stay low…

In fact, you hear people refer to a new normal. And –and reading some articles over the past month of so talking—a lot of people forecasting that the new

[83] T: 1624, 20-1626, 6

normal, we may not get to that 3.85 percent for ten year yields. We may, but I think it's going to take a while to get there.

137 The CAC's critique of Dr. Cleary does not acknowledge that his opinion was informed by a deep understanding of financial market conditions. His evidence on financial market conditions, even on its own, would be compelling evidence that the SIRF is optimistic.

5.3.3 Dr. Cleary: The Naïve Forecast Has Outperformed SIRF

138 Dr. Cleary has demonstrated that the naïve forecast, i.e. projecting the current actual interest rate on a flat basis, is a more powerful predictor of interest rates than any of the approaches used by the Board previously.

139 Dr. Cleary characterized the performance of the naïve forecast as a significant improvement[84]:

The overall weighted average forecast error using naïve forecasts was -0.73% - 57.6% smaller than the weighted average forecast error of -1.72% obtained when using the GRA forecasts. So clearly, simply using the naïve forecasting method would have improved the forecasting results significantly.

140 Dr. Cleary also cited empirical studies that suggested this phenomenon is common with forecasts, particularly since 2008. He stated in part[85]:

The empirical studies cited above which are based on comprehensive samples and analysis, suggest that this should come as no surprise to us, since economic forecasters did worse than naïve forecasts on average, with few actually "beating" such forecasts.

141 Dr. Cleary emphasized that this stands to reason, given that there is intuitively a smaller chance of being wrong when giving some weight to the current position. Dr.

[84] MPI Exhibit 8: page 13
[85] MPI Exhibit 8: page 13

Cleary advised that the "50/50" method would still be the best estimate when looking at a three year forecast period[86]:

> *Yes, it would. Just for the reasons I outlined earlier that I think there's –even over the shorter period you can see there's still substantial errors. And—and if you—again, I think starting out at the existing rate compensates for a couple things, that the rates could go in either direction, either in the same – the direction of the forecast, or it could surprise everyone and go the other direction.*
>
> *So if you weight in the existing rates you're going to minimize your forecasting error in the long run over periods of interest rate increases and decreases.*

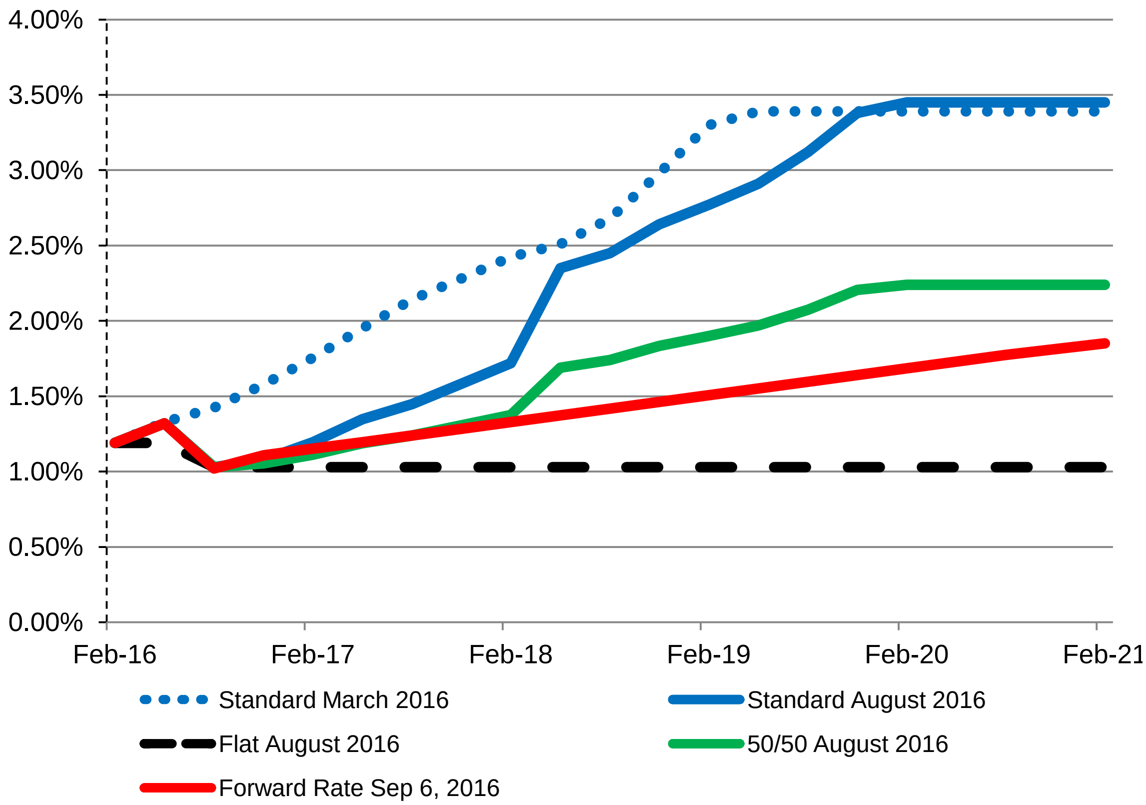
142 MPI submits that it would be difficult to characterize the SIRF as a best estimate in the face of this new evidence.

5.3.4 Market is Rejecting the SIRF

143 The market is trading based on an expectation that interest rates will rise slowly – indeed more slowly than even the 50/50 approach would suggest. This is objective corroborating evidence that the SIRF is not a best estimate, and that the 50/50 approach is reasonable.

144 MPI's Rebuttal Evidence included the following chart.[87] It 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.

[86] T: 1674, 21– 1675, 8
[87] MPI Exhibit 20: pages 16-17



145 MPI explained that the Forward Rate for the GoC 10 Year[88] "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. This evidence was unchallenged.

5.4 Using Best Estimate Has Favorable Implications

146 The adoption of a best estimate 50/50 approach has positive implications for rate stability and the Corporation's financial health.

[88] MPI Exhibit 20:pages 16-17; Bloomberg CAD Sovereign Curve dated September 6, 2016

147 Relying on the SIRF exposes Basic Autopac to a potential $32.7 million annual loss on average over the two year rating period if interest rates remain flat.[89] There should be no expectation of a capital transfer to address this shortfall. Even if the competitive lines were better capitalized, using an interest rate forecast that is not a best estimate would run counter to the principles articulated in Section 2.0 above. Mr. Guimond stated[90]:

> *And Basic rates need to be set to break even. We cannot knowingly systemically forecast revenue and expenditures that result in a non-breakeven situation for the Basic line of business and then expect that the competitive lines will be available to -- to cover that non-breakeven situation.*
>
> *As was indicated, the -- through the Kopstein Report, it -- it was indicated that Basic must hold its own and there be no cross-subsidization. So what we're concerned about is a transfer to deal with not using a best estimate is really contrary to the Kopstein principles, which required Basic to be self-sustaining.*

148 Mr. Guimond characterized the use of a best estimate interest rate forecast as a "factor for success" in this proceeding[91], emphasizing that it is "imperative to MPI that we manage the risk caused by the interest rate forecast".[92] Mr. Guimond also stated[93]:

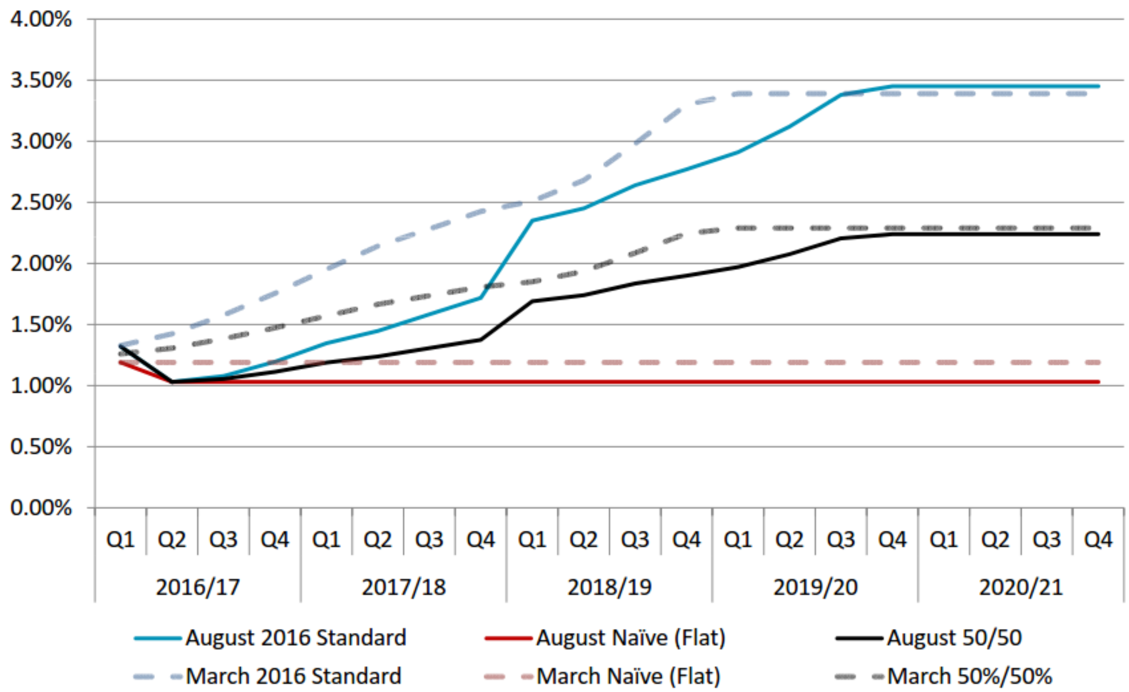
> *Based on Dr. Cleary's advice that a 50/50 interest rate forecast using equal weighting to the standard Naive forecast would be a best estimate, we prepared another rate -- rate indication for the Public Utilities Board to consider. It was a significant effort to prepare alternative rates and alternative DCAT, but it was a necessary part of the effort to get a solution in a collaborative manner.*
>
> *So if the Public Utility Board can accept that the proposed 50/50 interest rate forecast is a best estimate, the pieces fall into place after that. A best estimate interest rate gives us a best estimate of net income. That takes the pressure off*

[89] MPI Exhibit 6: slide 6
[90] T:163, 1-13
[91] T:158, 18-25
[92] T:160, 6-7
[93] T:157, 7-23

the RSR and moves the lower target down. We reduce the risk of needing an RSR rebuilding fee going forward, and that helps us get the stable and predictable rates we need.

149 As explained later in Section 7.0, obtaining certainty on these issues has a trickle down impact for MPI's/Department of Finance's ability to assess its investment strategy with an eye to determining the prudence of taking on greater risk.

150 MPI is still accepting significant interest rate forecast risk with a 50/50 weighting. The figure below shows the SIRF, 50/50 approach and naïve forecast.[94] The margin between the 50/50 and the naïve represents real risk to Basic Autopac, in the event that interest rates actually remain flat over the rating period. The predictive power of the naïve forecast in recent years also underscores the residual risk.



[94] MPI Exhibit 23: Slide 19

151 As indicated above, the market behaviour is generally supportive of a 50/50 approach, and notwithstanding the residual risk in the 50/50 forecast, accepts it as a best estimate.

5.5 IRFRF, Informed Through Collaboration, Was an Appropriate Proposal

152 MPI was pressed during the proceeding about its decision to apply for an IRFRF rather than incorporating a different methodology in the rate indication. Specifically, MPI was asked why it didn't file its Application based on a forecast that MPI considers to be a best estimate. MPI submits that the requested IRFRF is an appropriate response to unique circumstances. The IRFRF reconciled the PUB's order to use the SIRF with the fact that the SIRF is not a best estimate, and built on a history of successful collaboration.

5.5.1 The IRFRF Respects Past PUB Directives While Recognizing the Associated Risk

153 The previous Board order was unequivocal in mandating that the SIRF be used this year. It stated for instance[95]:

> *The Board has in the past expressed the view that the standard interest rate forecast prepared by the 5 major Banks and Global Insight is the best information that is available with respect to interest rate forecasts, other than longer term forecasts available for purchase, which MPI has not done. It is the view of the Board that MPI should utilize at least one additional longer term forecast to enhance the accuracy of the information on which MPI relies to prepare its interest rate forecast on which the GRA is based.* ***As such, the Board orders that next year, MPI file its application on the basis of the interest rate forecasting methodology used currently, and that it also file on the basis of an Olympic style average (i.e. excluding each of the highest and lowest values of the non-long term standard interest rate***

[95] Order 128/15: page 48

forecasts utilized), and utilizing at least one additional longer term forecast.

The Board notes that if the updated September 2015 standard interest rate forecast materializes, MPI's revenues will decrease in 2015/16 and following, such that the net result for 2016/17 and 2017/18 would not be a break even position. This is the case even after the implementation of full duration matching as at August 31, 2015.

[Emphasis added]

154 While the Board's direction was unequivocal, it was also evident from the Board's reasoning that the PUB Panel had expected the SIRF would be a best estimate for this 2017/2018 GRA rating period. The Board's 2014 Decision stated[96]:

The Board agrees with CAC that the Board should consider the most recent interest rate information available for rate-setting purposes, and as such the Board accepts the forecasts for Basic that include the updated October 2014 interest rate forecast. ***It is the view of the Board that the standard interest rate forecast prepared by the 5 major Banks and Global Insight is the best information that is available with respect to interest rate forecasts, other than longer term forecasts available for purchase, which MPI has not done.***

MPI has stated that is has no expertise in interest rate forecasting, and has submitted no evidence to support the submission that the Low Growth Rate Forecasting Methodology represents a best estimate and should be accepted. As such, the Board is not in a position to accept the Low Growth Rate Forecasting Methodology.

[Emphasis added.]

155 It makes little sense to require MPI to use something other than a best estimate, when that had not been the PUB's intention in directing MPI to use the SIRF.

[96] Order 135/14: page 44

156 Mr. Guimond explained MPI's desire to respect the PUB order, but at the same time explain the risk it was creating in light of the significant body of evidence that the SIRF is not a best estimate: "As the Public Utility Board had ordered us to use that forecast, we needed to find a way to comply with the PUB order, and fix the problem caused by the interest rate forecast."[97] Ms. Reichert reiterated this view[98]:

> *We engaged in a collaborative process. We wanted to be respectful of the order that was provided to us in last year by submitting our Application using the standard interest rate forecast, but at the same time, needed to highlight our concern with using the standard interest rate forecast as we did not believe that that was a best estimate and that we would be knowingly not requesting significant -- or sufficient, pardon me, sufficient premium in order to be able to sustain the Basic line of business.*

157 Ms. Reichert also stated[99]:

> *We felt very strongly that we always need to provide to the Public Utility (sic) Board what a best estimate is. All of the forecasts that we do, we always try to ensure that they're a best estimate with the information that we have at hand at the time. And so in order to respect the Ord --the Order from the Board, but also to express our --our deep concern about not using a best estimate for the interest rate forecast, that's why we submitted the application in the way that we did. And wanted to work collaboratively and -- and asked for the technical conference in order to be able to discuss all of the issues around how best to determine a best estimate.*

158 Ms. Reichert explained that, but for the Board's order, MPI "would have put forward what we felt was the best estimate interest rate forecast. And then we would have,

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[97] T:150, 20-23
[98] T:182, 24-183, 8
[99] T:353, 21 - 354, 9

instead of having the technical conference, have had the debate at this hearing about what is a best estimate interest rate forecast."[100]

159 It is important not to lose sight of the fact that the practical result is the same whether the issue is formulated as needing a better estimating approach, or needing to recognize the risk of using the forecasting approach directed by the Board. Simply put, the 2.3% component of the proposed rate change is attributable to recognizing that interest rates will be slower to increase than predicted by the SIRF. Any criticism of the way MPI formulated its requested relief is missing the real issue: rates should be set based on best estimates.

5.5.2 How this Risk Differs From Other Forecasting Risk

160 MPI's witnesses were asked what distinguished interest rate forecasting risk from the risk associated with any other forecast, such that a separate IRFRF was necessary. There is always an element of uncertainty associated with forecasting the future. But that uncertainty is reduced by using best estimates. The interest rate forecasting risk differs fundamentally from forecasting uncertainty related to claims costs. MPI's evidence was that claims costs are forecasted to produce best estimates.[101] No party took issue with that evidence. The difference with the interest rate forecasting risk is that additional risk is arising by virtue of not using a best estimate. Using the SIRF or Olympic-style forecast methodology is akin to operating with the expectation of losses.

161 Ms. Reichert expressed the distinction as follows[102]:

MS. HEATHER REICHERT: I think what is underlying the -- the interest rate forecast and making it different is that the Standard Interest Rate Forecast that had been used, and that had been ordered to be used is not a best estimate. So with respect to claims runoffs or any other forecast that we put forward to the Public Utility (sic) Board, we absolutely believe that we are using the

[100] T: 355, 23 - 356, 3
[101] T: 173; 355
[102] T:362, 5 - 363, 6

information that we have and we are putting forward a best estimate. That's the difference.

With respect to interest rates, we do not believe that the Standard Interest Rate Forecast is a best estimate. And that's why it -- it -- it's - - it's not from our perspective appropriate to knowingly put forward or have rates based on something that we strongly believe is not a best estimate. And hence that's why the different attention to this particular item. All of our other forecasts underlying the -- the rate application we do believe are best estimates.

5.5.3 The Value of the Collaborative Process

162 The Board has lauded and encouraged MPI's past efforts to collaborate with hearing participants.[103] The collaborative approach initiated by MPI on the IRFRF was a good faith, creative initiative to seek common understanding and consensus regarding the challenge posed by interest rate forecasting risk and potential options to address the risk. It augmented an exchange that would otherwise have taken place in the hearing alone.

163 As part of that collaborative approach:

- In the Application, MPI outlined the challenge posed by the Board-directed approach to interest rate forecasting. It set out the frequency and magnitude of forecast inaccuracy in recent years. MPI outlined the risks of employing the approved methodology and sought a collaborative approach.
- The Application identified the range of outcomes for an IRFRF, defined by the standard forecast and flat interest rate assumptions. The "book ends" are a 0% to 5% IRFRF on top of the 2% proposed rate increase.
- In anticipation of the technical conference, MPI circulated a draft agenda[104] to parties for comment.
- MPI circulated the expert report of Dr. Cleary. He confirmed the frequency and magnitude of the forecast error. Dr. Cleary identified that using the

[103] Order 128/15: page 57
[104] A draft agenda was circulated for comment approximately one week before the Technical Conference. No feedback on the agenda was received.

naïve forecast would represent a significant improvement over the performance of the current methodology.

- MPI outlined Options for addressing the forecasting risk, including:
    - Making a reasonable adjustment to the Standard Forecast. For instance, a half-slope change would yield a 2% IRFRF.
    - Using historical rate movements, e.g. 85% percentile or 123 bps would yield an IRFRF of 1.6%.
    - A judgment based approach based on risk tolerance.[105]

164 In response to questions posed at the technical conference, Dr. Cleary provided his expert opinion to attendees regarding the derivation of a best estimate. He advised that it was a 50/50 approach.[106]

165 Ms. Reichert concluded that the process was a success: “And I would say that, based on the discussion, the nature of the questions, and the overall robust coverage of the -- of the issues talking about the form and the magnitude, I felt that there was a good appreciation of what was being discussed.”[107] MPI submits that her conclusion was a reasonable one.

5.6 Varying the Inputs to the SIRF Does Not Fix the Problem

166 The problem of optimistic forecasts is not rectified by simply adding additional data sources to the SIRF, or by dropping the highest forecast in the SIRF.

167 Dr. Cleary explained that the issue is a more systemic one and interest rate forecasts of financial institutions tend to be clustered within a reasonably small range. As an illustration of this point - The Consensus Economics forecast, which uses a wide variety of data sources (17 different sources in the May 2016 forecast), has exhibited similar issues in recent years. The data sources include not only the

[105] MPI Exhibit 6
[106] PUB (MPI) 2-25: page 5
[107] T:387, 14 - 388, 3

big five banks, but also the Conference Board of Canada, University of Toronto, and J.P. Morgan, among others. Dr. Cleary stated in his Report[108]:

There are several other options available to obtain interest rate forecast data, several of which have been correctly deemed as inappropriate. One alternative would be to use the Consensus Economics Inc. forecasts, which are provided quarterly. While Consensus provides a summary of forecasts from a broader number of sources that includes the big five bank forecasts plus several other sources such as the Conference Board of Canada, University of Toronto, J.P. Morgan, etc. (e.g., 17 were included in their May 2016 forecast), they are not as "timely" as the bank forecasts since they tend to wait until most of their sources have released their forecasts. In addition, they only provide forecasts for the following two years, and do not break the forecasts into quarterly forecasts. Also, the Consensus forecasts are heavily influenced by the Bank forecasts, and tend to be close to them, so it does not seem like an alternative that would add much, if any value.

168 When asked at the hearing about adding more forecasts to the SIRF, Dr. Cleary responded[109]:

I think that it will not hurt. More data is better than less. But I don't think you're going to see significant gain from it as you will be incorporating the existing yields because for all of the reasons that I mentioned before.

169 MPI and Dr. Cleary were asked about the possibility of including longer term forecast to add to the one provided by Global Insight that is in the SIRF. Both agreed that adding longer term forecasts wasn't the answer. Dr. Cleary stated that[110]:

[108] MPI Exhibit 8: page 8
[109] T: 1649, 25 -1650, 22
[110] T: 1653, 20–1654, 11

...if it's easy to do and it doesn't cost you in terms of timing, and they have all the information that you want, then certainly having more information is always better than having less information.

But if the costs in terms of timing, or that you can't get the full information you need then I would say then it's not worth , really gathering that data from another forecaster, for example...honestly I cannot say that I know the exact timing of these organizations and when they come out with their predictions.

But I do know from looking through the Consensus Economics forecasts numerous times that they're almost always the same, and I could probably pick any six out of that twelve and get the same average.

170 Ms. Reichert explained that, since a GRA is focused on a two year period, incorporating additional longer-term forecasts is not the answer[111]:

[Ms. Grammond] As it's been done up to this point, the only long-term inclusion is global, so it's -- there's no opportunity for input from various sources. Would -- would not including or considering including other long-term forecasts be one way to improve upon that Standard Interest Rate Forecast?

MS. HEATHER REICHERT: Again possibly but I think minimally improve. We don't -- as -- as I mentioned before the focus and what is important for the Public Utility (sic) Board to understand, in establishing our rates we are looking at the next two (2) years from the year that we are currently in. Years three (3) and four (4) from the year that we are currently in, which is where the long-term forecast will tend to provide different or more information than what the bank forecasts do, do not factor into the interest -- or, pardon me, the premium rate indication that we are asking for at -- at this hearing.

So while I appreciate that the bank forecasts cover -- in this situation they cover the '16/'17 and '17/'18 year, and part of '18/'19, Global Insight is -- is mostly relied on for '18/'19, but again we -- we actually -- I think we even did different scenarios where we tried to use different long-term forecasters that

[111] T:391, 9 - 392, 7

actually had timely information that could be used in conjunction with the information that we had, and the impact again was not of -- of significance to make it worthwhile for us to change our Standard Interest Rate Forecasting method.

5.7 Forecasting Interest Rates in the Next GRA

171 MPI submits that the Board should permit MPI to put forward its best estimate and defend it, consistent with typical practice. Mr. Guimond articulated this request as follows[112]:

MR. DAN GUIMOND: The -- the best outcome for us as -- as a Corporation would be for the Board to allow MPI -- because -- because we know -- you saw the -- the forecast on the futures, and so on, and -- and you're quite right that as time goes by this is something that needs to be looked at on an ongoing basis. The best outcome for the Corporation is that you would allow the Corporation to always put Investment Income forward its best estimate and defend it versus putting in the order use this interest rate forecast or use this. If -- if you could remove the shackles from us and allow us to really put forward what we think is -- is the right -- over time because it will change over time, then we can then have the discussion and -- and support it.

You -- you can see the -- the forecast is even lower than the -- on the futures market even lower than the 50/50. So, I mean, there's -- there's still a lot of risk there in the 50/50. So the best outcome for us is please allow us to -- to do the best -- the best estimate. That's -- that would be our desired approach on a go-forward basis.

172 While it remains to be seen what that best estimate will be next year, Ms. Reichert expressed MPI's expectation that, if permitted to do so, the Corporation would be

[112] T: 379, 17 - 380, 14

"using the 50/50 interest rate forecast as a best estimate, and that will be embedded within all of our -- our forecasts and will be underlying whatever rate indication we have next year."[113] Her expectation reflects Dr. Cleary's view that there is no "stale date" for a 50/50 approach, and it remains suitable for the future applications. Dr. Cleary outlined this view in the Hearing as follows[114]:

It also protects you against the possibility that rates could decline further before they actually increase. So I - I – there's no best before date. If we're a year from now and rates are, you know, still the same and people are predicting them to go up or –- I think it's still going to work best to minimize the variance.

Or if a year from now in the unlikely event ten year rates were 2 percent and people were forecasting the decline, I think you'll still minimize your variance by incorporating the existing rates at that point.

And so short answer, no expiry date. I think it would work very well at any point.

5.8 MPI Response to Dr. Simpson's Evidence on Interest Rate Forecast

173 The Corporation's response to the evidence of Dr. Simpson addresses four key areas. First, Dr. Simpson's stated definition of a best estimate and his archery analogy are consistent with the 50/50 approach, not the SIRF. Second, Dr. Simpson incorrectly identifies a double counting of interest rate forecasting risk. Third, the RSR is not a substitute for good forecasting. Fourth, Dr. Simpson argues that a best estimate of interest rates forecasts should account for historical periods of inflation, but argues against using inflation scenarios in determining the DCAT. Fifth, the fact that the IRFRF is a unique approach is argument, not expert evidence, and is unpersuasive.

5.8.1 Definition of Best Estimate and Archer Analogy

[113] T: 361, 18 -21
[114] T: 1684, 8-21

174 Dr. Simpson's own definition of a best estimate, and his mid-point approach encapsulated in the 'archer' analogy, support the use of the 50/50 interest rate forecast.

175 Dr. Simpson was asked by counsel for both the MPI and the PUB[115] what his definition of a best estimate would be. He offered the following in response to MPI Counsel[116]:

> *DR. WAYNE SIMPSON: A best estimate is typically a midpoint of a range of possible outcomes that's established, let's say, be regression estimate as the expected value or outcome, or mean outcome. I -- I'm assuming that's what you mean. I just -- I'm not sure what you mean by, "best." I thought I'd better clarify.*
>
> *MR. MATT GHIKAS: An estimate that's neither conservative nor unconservative, correct?*
>
> *DR. WAYNE SIMPSON: That's correct.*
>
> *MR. MATT GHIKAS: Unbiased, statistically?*
>
> *DR. WAYNE SIMPSON: Consistent, unbiased, yes.*

176 The definition offered by Dr. Simpson is consistent with 50/50 interest rate forecast approach advocated by Dr. Cleary. Dr. Simpson admitted that the SIRF was exhibiting upward bias over the period since 2008[117]:

> *MR. MATT GHIKAS: Now, as an econometrician, sir, what does this data and the figures say about the predictive power of the SIRF over this period?*
>
> *DR. WAYNE SIMPSON: It's under-performed over a relatively short period of observation, yes.*
>
> *MR. MATT GHIKAS: Right. And it's -- it's performed poorly, hasn't it?*

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[115] T: 2077, 21-2079, 5
[116] T: 2028, 25 - 2029, 13
[117] T: 2035,15 – 2036, 9

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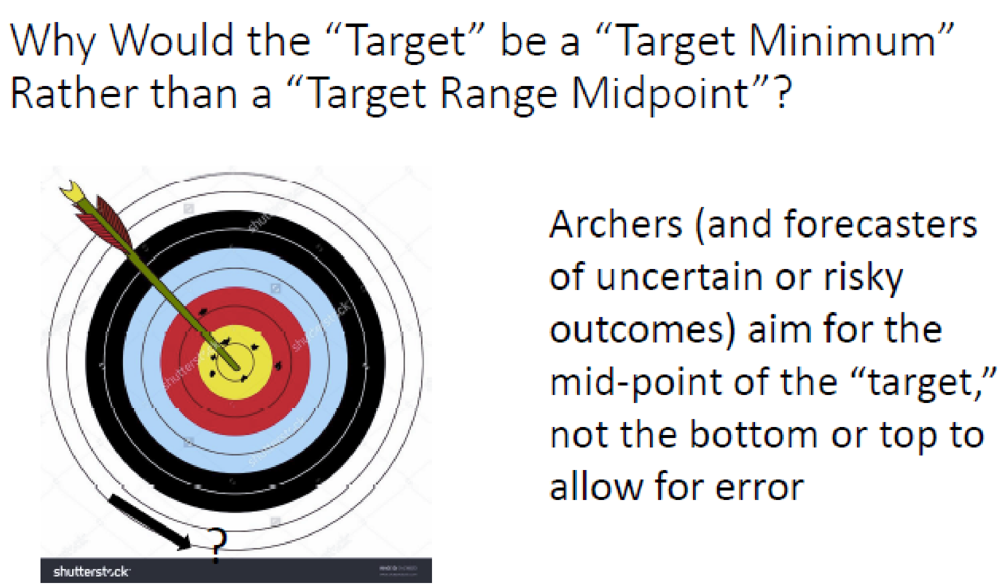
DR. WAYNE SIMPSON: It has -- it has consistently overestimated the interest rate rebound.

MR. MATT GHIKAS: You'd agree with me, sir, that this is demonstrating characteristics suggestive of statistical bias?

DR. WAYNE SIMPSON: Only over this short period, yes. I wouldn't -- I wouldn't fore -- if I were assessing the forecast behaviour of the Standard Interest Rate Forecast, I wouldn't restrict myself to this relatively short and, as I've admitted, unusual period of -- of sustained low interest rates.

177 With respect to Dr. Simpson's point about looking at more data, Dr. Cleary did provide more data, as discussed later.

178 Dr. Simpson also relied on the 'archer' analogy in describing his preferred approach the RSR, as described by the following slide[118]:



179 This analogy is equally applicable to the best estimate of interest rate forecasts, and the determination of a best estimate that is the mid-point of the range.

[118] CAC Exhibit 26: slide 5

5.8.2 Double Counting Interest Rate Forecasting Risk

180 Dr. Simpson's evidence is that the IRFRF double counts the risk of interest rates falling short of the forecast, which he contends is already accounted for in the DCAT based RSR target[119]. He originally raised this point based on the SIRF- based DCAT, which would have been correct had MPI not re-run the DCAT to reflect the 50/50 approach. However, in cross examination, it was evident that Dr. Simpson was confused as to how the DCAT responded to changes in interest rate forecasts.

181 The DCAT accounts for the reduced interest rate forecasting risk posed by the 50/50 interest rate forecast: the lower RSR target under the 50/50 is $159 million, as against a $181 million with the SIRF.

182 The fact that the RSR and the IRFRF both account for interest rate forecasting risk does not mean they do so for the same purpose. The IRFRF is designed to ensure a best estimate of break even net income. The DCAT is designed to establish a lower capital reserve target to ensure the satisfactory financial condition of Basic based on best estimates.

5.8.3 RSR Not a Substitute for Good Forecasting

183 Dr. Simpson's view appears to be that we should not be concerned about the SIRF's accuracy because the RSR is there to absorb losses. As MPI explained in its rebuttal evidence to Dr. Simpson, the RSR cannot substitute for break even rates[120]. The IRFRF (using a 50/50 best estimate interest rate forecast) is intended to result in a best estimate of break even net income.

184 Ms. Sherry agrees with MPI's position, and contradicted Dr. Simpson, in stating[121]:

> *MR. MATT GHIKAS: All right. Would you, as an actuary, use that estimate anyway simply because -- in conducting our actuarial rate analysis simply because there's sufficient capital to absorb a loss?*

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[119] CAC Exhibit 26
[120] MPI Exhibit 20: pages 13 -14
[121] T: 2049, 24 – 2050, 15

MS. ANDREA SHERRY: I would use the best estimate I could come up with, and believed to be the best estimate, in my base scenario for the DCAT.

MR. MATT GHIKAS: Right. And you'd agree with me if I said to you that solid forecasting is the key?

MS. ANDREA SHERRY: Yes.

MR. MATT GHIKAS: Okay. ***And you'd agree with me if I said to you that the RSR cannot be seen as a substitute for good forecasting, right?***

MS. ANDREA SHERRY: ***I think we've all agreed to that.***

[Emphasis added]

185 More accurately, “we’ve all agreed to that” apart from Dr. Simpson.

5.8.4 Accounting for Inflation – Inconsistent Position

186 Dr. Simpson was asked to explain his views on why he couldn’t conclude that the SIRF was a best estimate. He indicated that 8 years of data was insufficient to draw statistical conclusions about the bias of the SIRF.

187 When pressed on how much data was required, on how far back in history the comparison should go, he indicated that we are in a unique period of history from an economic perspective, and that one should consider periods with inflation[122]:

MS. KATHLEEN MCCANDLESS: When – for financial modeling, for your purposes, what do you use for changes in interest rates?

DR. WAYNE SIMPSON: Well, I don't forecast interest rates on a regular basis in teaching students about labour economics, or in doing research on income maintenance programs. But if I were forecasting interest rates right now -- is that what you're asking me? What would I do?

MS. KATHLEEN MCCANDLESS: Yes.

[122] T: 2083, 5 - 2084, 4

DR. WAYNE SIMPSON: I would -- I would look back at the forecasting record. ***I would certainly give some significant weight to what has gone on in the last five (5) or six (6) years****, but I would probably look back further than that at -- at interest rates. I mean, I think the presumptions that interest rates at some point will rise are based on some historical understanding of -- of the -- the performance of the economy -- the economies of the world, and --* ***and the nature of monetary policy, which is that once economies begin to grow in a more robust fashion, there will be pressures on interest rates to rise to ward off inflation.***

[Emphasis added]

188 This position is at odds with results of the collaborative process on the DCAT which determined that inflationary periods should be removed, and that inflation targeting by the Bank of Canada removes the risk of inflation for the purposes of DCAT modeling.

189 The impact of inflation can't be ignored for the purposes of setting capital reserves, while simultaneously being a relevant factor to the determination of a best estimate of break even net income.

190 Further to Dr. Simpson's point that more historical data is required to assess bias in the SIRF, Dr. Cleary provided peer reviewed articles which demonstrate that interest rates forecasting performance has been biased, or no more accurate than a random walk model[123]:

For example, a 2008 study by Spiwoks, Bedke and Hein evaluated 10-year US government bond yield and three-month US Treasury bill rate forecasts over the period October 1989 to December 2004. They found that "not one of the forecast series proved to be unbiased," and further concluded that "the information content of most of the forecast time series is lower than that of naïve forecasts." These findings are consistent with those of Mitchell and Pearce (2005), who examined economists' six-month ahead forecasts over the 1982-2002 period. They concluded that "the forecast accuracy of most of the

[123] MPI Exhibit 8: page 14

economists is indistinguishable from that of the random walk model when forecasting the Treasury bill rate but that the forecast accuracy is significantly worse for many of the forecasters for predictions of the Treasury bond rate and the exchange rate.

5.8.5 Uniqueness of the IRFRF is Not a Reason to Use Poor Estimate

191 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.[124] This is advocacy, not expert evidence. It is also unpersuasive.

192 The IRFRF is a means of reconciling the PUB's Order with the use of 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.

193 The determination by the PUB, on rates charged for Basic auto insurance, should be made on the facts surrounding the present circumstance of MPI

5.9 The Academic Literature supports Dr. Cleary

194 CAC's closing submission asserted in the following slide that Dr. Cleary's expert opinion was undermined by the authority he relied on in his recommendation[125]:

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[124] CAC Exhibit 26: page 11
[125] CAC Exhibit 27, slide 150

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Challenges with the Evidence of Dr. Cleary

150

his assertion of a likelihood of mean reversion is undermined by one of the individuals he relies upon as an authority (Spiwok) who describes a Robust Tendency to Status Quo Bias (2008 and both 2011 studies) *SC, Oct 27, p. 1713-15*

Consumers' Association of Canada (Manitoba Branch)

195 CAC fundamentally misunderstands the evidence of Dr. Cleary, and the results of the “post financial crisis” studies they put to Dr. Cleary:

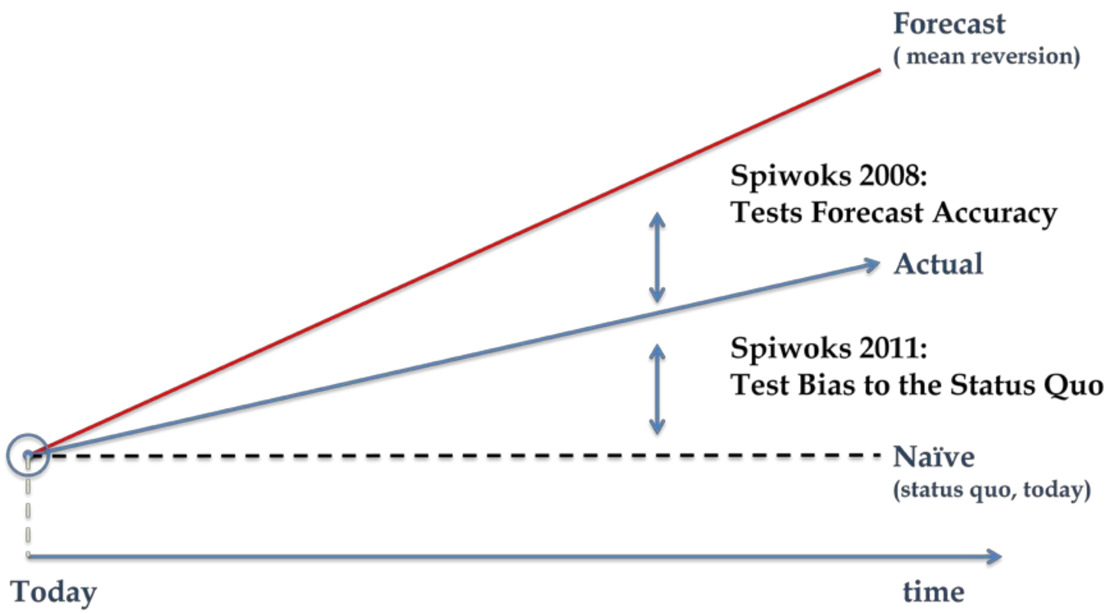
- The 2011 Spiwoks paper tests and confirms the <u>tendency to status quo bias</u>, which means a <u>bias toward the naïve forecast.</u>

- Dr. Cleary never suggested there was a ‘liklihood to mean reversion’.

- Dr. Cleary’s evidence is that there is a tendency for <u>actual</u> rates (not rates <u>forecasted</u> by an economic forecaster) to be closer to the “status quo”, also referred to as the “naïve forecast”.

- The result of the 2011 Spiwoks paper supports a naïve approach.

- The 2011 Spiwoks paper does not actually test for forecast accuracy, as does the 2008 Spiwoks paper. The test for tendency to status quo bias is not the same as a test of forecast accuracy. The following diagram conceptually illustrates the differences in the 2008 and 2011 Spiwoks papers:



196 CAC quoted only a small portion of the relevant exchange. A complete review of the dialogue is illuminating. Dr. Cleary elaborated on the conclusions of the papers brought by the CAC, explaining what is meant by the "robust tendency towards a status quo bias" on the part of forecasters[126]:

> *So the paper that I read when I got to my room last night, the 2011 paper by Spiwoks et al., discusses that. And, basically, the -- the other paper that you just mentioned, the status quo bias of bond market analysis, uses the exact same dataset, and basically just uses a different statistical test, from what I can see, to come to the same conclusion.*
>
> *So the two (2) papers using the same dataset comes to the same conclusion just using different statistical tests.* ***And so what he's suggesting in here is that forecasts -- forecasts tend to be related to recent levels of interest rates, which seems quite obvious to me that that would be a good starting point and, in fact, is what -- what I'm forecasting****.*
>
> [Emphasis added]

[126] T: 1713, 23 – 1714, 13

197 Dr. Cleary further commented on the 2011 Spiwoks paper, indicating that it did not actually test for forecast accuracy, and was not on its face, germane to his study[127]:

MR. BYRON WILLIAMS: -- to my question though. Is the general premise of Spiwok -- you read his 2008 report as well. Is the general premise that there is a robust tendency towards a status quo bias towards recent forecasts -- or recent -- would that be fair, sir?

That's his conclusion whether you agree with it or not.

DR. SEAN CLEARY: Yes, that is his conclusion. And I don't agree with some of the things, the way he's interpreted things.

MR. BYRON WILLIAMS: Okay. Fair enough.

DR. SEAN CLEARY: Although I will say there's a lot of statements in there that would support what I'm saying, is -- which is that they have -- and I will also note about both of these papers, that he is not -- in these papers ***does not actually test the accuracy of these forecasts****.* ***There's no formal tests of the accuracy of the forecast as there is in the 2008 paper****.*

[Emphasis added]

198 The CAC's assertion that Dr. Cleary has produced a 'light' report is without merit. The CAC has confused concepts and offered no quantitative analysis of its own, elementary or otherwise, to assist the Board.

199 The CAC's assertion that Dr. Simpson's retainer was very different from Dr. Cleary's is not compelling. Dr. Simpson produced a report entitled "A Note on an Interest Rate Forecast Risk Factor (IRFRF) and the RSR Target Established by the Dynamic Capital Asset Test (DCAT)". Dr. Simpson had ample opportunity to test the predictive power of the SIRF, but chose to rely on the authority of the forecasters, as he did not consider himself to do better.[128]

[127] T: 1714, 21 - 1715, 16
[128] PUB(CAC)1-1

5.10 Further Workshops on Interest Rate Forecasting

200 The PUB should reject the proposal of the CAC to revisit the issue of interest rate forecasting jointly with Manitoba Hydro on the following grounds. First, it will further delay the Board's determination on this critical matter. MPI has brought the application seeking relief for 2017 rates, and has provided ample and persuasive evidence that such relief is both necessary and prudent.

201 Second, the PUB should make its determinations based on the evidence of the record before it. In past orders the Board has opted not to make determinations on MPI's rates, based on the evidence on the record for other utilities[129]:

> *The Board has reviewed the option that MPI put forward, including MPI Exhibit 8 which reflects its predictions with respect to interest rate activity, but the Board has heard no expert evidence with respect to interest rate forecasts* ***as it did in the Centra Gas and Hydro hearings*** *prior to making a decision with respect to interest rate forecasting methodology.*
>
> [Emphasis added]

[129] Order 151/13: page 32

6.0 Rate Stabilization Reserve

202 Having a sufficient capital reserve is foundational to any insurance company, whether it is private or public. Capital reserves are, in SGI's words, an insurer's commitment to pay claims liabilities. They are there to ensure that the insurance company can withstand unforeseen losses, preferably with minimal rate volatility. It is time to bring closure to the long-running discussion on the definition and purpose of the RSR, and finalize the lower and upper limits. MPI submits that its proposals for the RSR are an appropriate basis to move forward. With these foundational requirements set, MPI will be in a better position to maintain rate stability and secure the long-term position of public automobile insurance in Manitoba. The CAC's preferred approach of a reduced and thinner RSR will have the opposite effect.

203 MPI elaborates on the following points in this section:

a. First, MPI's proposed modification to the definition of the RSR is appropriate and reflects how the RSR has always been used.

b. Second, the RSR lower threshold should continue to be determined consistent with the DCAT analysis determined through a lengthy collaborative process.

c. Third, the proposed RSR upper threshold of 100% MCT should be approved on a final basis, as it will provide MPI with greater flexibility to absorb losses without requiring an RSR rebuilding fee.

204 Section 7.0 will address the point that having certainty around the RSR parameters is a precondition to considering an investment strategy targeting higher returns, which interveners like CMMG have argued for.

6.1 RSR Definition Reflects How RSR Has Always Been Used

205 In Order 128/15 the Board requested that the Corporation provide a revised definition of the RSR.[130] The Order was issued because an intervener had expressed concerns in two successive proceedings that the definition, as written, did not encompass the Corporation's long standing practice that annual net operating results of Basic constitute unexpected or non-recurring events or factors.

206 To address this concern the Corporation filed the following proposed definition for the Rate Stabilization Reserve[131]:

> *To protect motorists from rate increases made necessary by* ***unexpected variances from forecasted results and*** *by unexpected events and losses arising from non-recurring events or factors. [bold are the proposed additions to the definition]*

207 This definition accurately reflects the Corporation's long held understanding and practice associated with the purpose of the RSR, and is in accordance with PWC evidence filed at last year's General Rate Application[132]. No party has questioned the proposed definition. The Corporation submits the definition should be formally confirmed by the Board in this hearing, bringing resolution to a fundamental element of the RSR.

6.2 RSR Lower Limit is Already at the Absolute Minimum

208 It is also necessary to bring closure to how the lower end of the RSR is established. MPI submits that the Board should reaffirm the approach approved last year for determining the lower RSR threshold going forward, recognizing that it is already very low. It still leaves the Corporation vulnerable to plausible adverse scenarios, and it would be imprudent to now treat 1-in-40 as a target and accept a tolerance band as low as 1-in-10, as being suggested by Dr. Simpson and Ms. Sherry. After

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[130] 2016 GRA: Volume II, RSR, Appendix B
[131] MPI Exhibit 1: Volume I, OV., page 47
[132] 2016 GRA: Volume II, RSR, Appendix A

many years of discussion, last year the Board ordered that the DCAT[133] methodology be used as the basis for determining the lower end of the RSR. Last year, the Board ordered[134]:

That the two year return period, 1-in-40-year probability level, Combined Scenario including Management and Regulatory action should be utilized for the purpose of setting the lower Total Equity capital target for Basic.

209 The Board's endorsement of the DCAT-based approach represented a very significant change of approach and its importance cannot be understated. Prior to that Order, the calculation of the size of the RSR was based upon percentage of premiums written. Premiums written have no direct correlation to the risks that face the financial condition of the Corporation. The percentage of premiums written selected by the Board had yielded very low RSR thresholds; for the 2015/16 rating year the range was $89 million to $177.7 million. These values do not reflect the reality of the risks facing the Corporation. As discussed later in Section 7.0, the low and narrow capitalization band necessitated conservative, risk adverse investment decisions.

210 As approved last year, the lower end RSR target is intended to reflect the minimum amount of reserves necessary to ensure a satisfactory financial condition based on all 1-in-40 year scenarios modeled. Stated another way – it identifies the minimum amount of the RSR at the start of the rating period such that the reserve would stay above zero dollars for all 1-in-40-year scenarios modeled. Falling below zero means that the chief actuary cannot sign off on the satisfactory financial position of Basic. As Mr. Johnston testified the DCAT 1-in-40-year scenarios have been exhaustively tested in a transparent and collaborative process.[135] The result of the DCAT analysis is that the lower end of the RSR target is $159 million for this rating period.[136]

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[133] Dynamic Capital Adequacy Testing, or DCAT, is described in MPI Exhibit 1: Volume I, OV.15, page 50
[134] Order 128/15: page 57
[135] T: 23, 16-17
[136] T: 233, 21-24

211 While MPI accepts a $159 million lower threshold this year it should be recognized that the amount is very low – equal to 26% MCT [137]– by virtue of the more aggressive assumptions incorporated through the collaborative process. Mr. Johnston's lack of enthusiasm for the modeling assumptions incorporated through the collaboration process was evident at the hearing. Mr. Johnston has characterized the RSR minimum as the lowest he would be willing to endorse as representing a satisfactory financial condition[138]:

> *I can say though that the DCAT that we have today, it would be difficult for me to sign that report at any -- any lower of a number. Like we've really, you know, stressed those assumptions as – as much as we can. We've removed some historical periods that are very relevant from that modeling, but I've characterized them as reasonable but I'd struggle to go any lower than that.*

212 A 1-in-40 year scenario falls well short of capturing all plausible adverse events, and there is a real prospect that Basic Autopac could lose more than $159 million in a short period of time. This is underscored by the fact that MPI has just had experience very similar to a 1-in-40 year scenario. As Mr. Johnston testified[139]:

> *Our last three (3) years of actual experience has been very close to our one (1) in forty (40) scenario. We've had stock market crashes. We've had deteriorating interest rates and we've had poor claims experience, so we're -- as we've talked about in here, we've had two (2) $70 million plus transfers in the last two (2) years.*

213 It will not be possible to bank on further transfers going forwards.

214 The fact that the RSR minimum is based on DCAT probabilities that are not remote should suggest a higher upper RSR target, and wider RSR "band". It is one thing to decide not to actively rebuild capital above a low level (the RSR minimum), but it is another thing altogether to rebate funds when the amount of capital retained (the

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[137] MPI Exhibit 17: page 21, 12-13
[138] T: 239, 14 - 240, 4. See also; T: 412, 5-17
[139] T: 235, 3-9

RSR maximum) is still relatively low compared to any other insurer in Canada, public or private. MPI should have sufficient capital available to it above the lower RSR threshold to absorb losses without falling below the minimum. MPI's proposed upper target, discussed later in this section, provides that flexibility.

6.2.1 MPI Response to Dr. Simpson and Ms. Sherry on Lower RSR Target

215 Dr. Simpson and Ms. Sherry continue to argue for an RSR target, around which a band should be established. In their evidence they argue for a target based on the 1-in-40 Combined scenario with a target range going as low as a 1-in-10 scenario[140], which equates to $152 million without management action (based on the June 17th DCAT report) and less still with management action. The effect of this recommendation is to significantly increase MPI's exposure.

216 The practical interpretation of a 1-in-10 DCAT probability is that the Corporation could expect to find itself insolvent on average once a decade, even with management action. Further Ms Sherry confirmed that Actuarial Standards of Practice would prohibit an actuary from signing off on a required DCAT at the 1-in-10 year probability level[141]:

MR. MATT GHIKAS: Okay. Now, as a professional actuary, do you routinely endorse a DCAT based on a one (1) in ten (10) risk tolerance?

MS. ANDREA SHERRY: In the private world, no.

MR. MATT GHIKAS: Okay. Not in any world I assume?

MS. ANDREA SHERRY: I've only done DCATs in the private industry. I've never done a DCAT for a public company.

MR. MATT GHIKAS: Okay. And I assume that's not -- that your own DCAT at Wawanesa, we won't get into the specifics of it because it's probably commercially sensitive. But your own DCAT analysis would belooking at more

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[140] CAC Exhibit 26: slide 8
[141] T: 2070, 11 – 2071, 3

remote probabilities than that one (1) in ten (10) by a significant margin, wouldn't it?

217 MS. ANDREA SHERRY: Yes.Ms Sherry also indicated that it would not be prudent for the Corporation to operate with a risk of insolvency, just because it is a crown corporation[142]:

MR. MATT GHIKAS: Okay. Now, you'd agree with me that it's important for MPI to remain solvent, first of all?

MS. ANDREA SHERRY: Yes.

MR. MATT GHIKAS: And it wouldn't be sound business practice for a Crown corporation to run itself with a willingness to become insolvent, correct?

MS. ANDREA SHERRY: Correct.

MR. MATT GHIKAS: Even if that means - even if it's backed by the provincial government, right?

MS. ANDREA SHERRY: I don't believe that insolvency is a risk for MPI.

MR. MATT GHIKAS: My question was whether -- whether it would be appropriate for MPI or a Crown corporation to run itself without concern for insolvency simply because it was a Crown corporation?

MS. ANDREA SHERRY: Certainly not.

218 Their proposal to establish an RSR target at the level of the current minimum (which is already 'watered down'[143]), and establish a range around that target where the lower threshold is so low that the Corporation could expect to become insolvent once a decade, is without merit and should be disregarded.

219 The Corporation can accept the continued use of the DCAT, as defined through the collaborative process, but notes that the Corporation's appointed actuary, Joe

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[142] T: 2060, 1-19
[143] T: 412, 12 - 414, 8

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Cheng, advised in his DCAT peer review, that the DCAT minimum capital target be converted to an MCT ratio.[144]

6.3 Proposed Upper RSR Target is Appropriate

220 The third component of the RSR debated in this proceeding is its upper end target. In order 128/15 the Board characterized the importance of the upper limit of the RSR as being that it precludes any Board ordered rebates unless the amount in the reserve exceeds the upper limit. The Board "approve[d] the use of a 100% MCT ratio on a notional basis only."[145] MPI submits that approving an upper limit in a manner that affords some predictability is key, and a 100% MCT upper threshold is appropriate.

6.3.1 Width of RSR Band Influences Rate Stability and Investment Strategy

221 Having (i) relative certainty in the RSR parameters, and (ii) sufficient room between the lower and upper limits allows for greater flexibility in setting investment policies and ensuring rate stability.

222 The situation MPI is trying to avoid is one where funds are rebated in one year, and an RSR rebuilding fee is required in subsequent years because of unforeseen events occurring. This type of volatility is undesirable and avoidable.[146]

223 When the Corporation has a narrow RSR range, it risks rate volatility unless it invests in low risk, low return investments. As Ms. Reichert stated[147]:

> *...at the time that we did the ALM study our RSR reserve was in the 10 to 20 percent of written premium range, not based on risk factors specific to the Corporation. That resulted in us not having enough money in the bank to be able to take more risk with the investments that we were making.*

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[144] MPI Exhibit 1: Volume II, RSR-2, page 10
[145] Order 128/15: page 58
[146] T: 414, 4 -8
[147] T: 847, 3 -9

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224 Aon recognized the importance of the RSR band width as a parameter to any asset liability study. It recommended revising the RSR targets to increase the band relative to the modeled amounts.[148]

- Revise the RSR targets
  - Rationale: The modeled lower and upper RSR targets are in part responsible for frequent large rate adjustments
  - A larger distance between the lower and upper RSR targets would reduce the likelihood of rate adjustments
    - The distance between targets should reflect the volatility of the RSR
  - Smoothed rate adjustments could be used to reduce rate volatility
  - Further study would be required to determine the most attractive approach

225 Ms. Spiropoulos also noted in answering questions from Board Counsel that is recent years “RSR targets were being hit very frequently, and that was causing large rate adjust—frequent rate adjustments.”[149] As discussed next in Section 7.0, this underscores why the parameters of the RSR must be finalized before MPI and the Department of Finance can entertain a different investment approach.

6.3.2 MCT is a Reasonable, Objective Basis for Determining Upper RSR Limit

226 There was at last year’s hearing and at this year’s hearing discussion on whether MCT – the risk-based test established by the Office of the Superintendent of Financial Institutions (“OSFI”) to measure the financial health of federally regulated insurers - is the appropriate basis for determining the upper limit of the RSR. The preoccupation with the type of risk-based test used to express the dollar threshold is really a side issue to the more fundamental point that MPI needs to know it will have sufficient capital available to manage rate volatility and have flexibility in its investment strategy. However, MPI submits that MCT is an appropriate test for two main reasons.

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[148] PUB (MPI) 1 -20 (a): Attachment B, slide 14
[149] T: 1234, 18 -21

6.3.2.1 Manitobans Can Compare MPI to Other Insurers

227 First, MCT provides MPI and the PUB with an objective, risk based test for determining when capital can be rebated. Mr. Johnston emphasized that it allows for “apples to apples” comparison among insurers[150]:

> *So the MCT is a standardized test used by the Office of the Superintendent of Financial Institutions, or OSFI. They oversee -- they're the federal regulator of all federally regulated insurers in Canada. The MCT is -- is there to assess risk faced by the P&C industry. So it is a -- obviously a risk-based approach, and there's various risk loads that are applied to balance sheet items, basically assets, liabilities, and based on that information a minimum capital requirement is determined.*
>
> *The -- one of the key benefits of this approach obviously is that there's a fairly objective, consistent methodology that's applied in the same manner to all insurers that OSFI regulates, and so there's consistency in the approach. There's not a -- different judgments of all these different insurers, and -- and the staff that work for those insurers. There's one (1) standardized test.*
>
> *....*
>
> *As I mentioned, other govern -- other public insurers have arrived at the same conclusion, that this is an appropriate test for a government insurer. It's independent, objective, externally developed measurement of risk, so there -- the subjectivity piece isn't there. It's also easily comparable to other insurers.*

228 CAC filed an excerpt from a Financial Services Commission of Ontario document on MCT (CAC Exhibit #17), which echoed Mr. Johnston’s point about consistency among jurisdictions. It stated in part:

> *It was developed to ensure consistency among jurisdictions through Canada, by applying the same capital framework to P&C insurers operating in Canada.*

[150] T: 229, 16 - 230, 8

229 For our purposes, the importance of an "apples to apples" comparison with other insurers is that Manitobans can see objectively that MPI is retaining less policyholder premiums than any other insurer in the country, public or private.

6.3.2.2 Risk-Based Test With Information Advantages

230 Second, MCT is a good risk-based test. OSFI has taken advantage of a broad pool of information in developing the Minimum Capital Test. Mr. Johnston stated[151]:

> *There's a lot of experts that have spent time studying this. OSFI has huge informational advantages over MPI. They're looking at every fed -- federally regulated insurer in the country.*
>
> *They have, yeah, a huge informational advantage over -- over MPI. So we think it's very prudent to use this industry-wide test as the upper --as the upper range for our RSR.*

231 A test that is good enough for every other insurer in Canada should be good enough for MPI.

6.3.3 100% MCT is an Acceptable Upper Limit

232 It is notable just how much lower MPI's proposed RSR range is below other Canadian insurers, public or private.

233 Mr. Johnston noted that "The average, last time I checked, MCT score of a private insurer was 225 percent."[152] OSFI will actually intervene when an insurer's capital falls below 150% MCT. Mr. Johnston noted that lower targets are warranted for public insurers relative to the private insurers, because they do not face "strategic type risks, operational risks, things like that", but he emphasized: "the core portion

[151] T: 232, 5-12
[152] T: 231, 13 -14

of the test is really just looking at the risks of different type of assets and liabilities. And those risks exist whether you're a monopoly or a private insurer."[153]

234 Consistent with Mr. Johnston's evidence. ICBC has a legislated minimum of 100% MCT, and only rebates above 160% MCT. Contrary to what CAC indicates on slide 179[154], the BCUC (an independent tribunal) has determined the capital target levels above 100%. SGI has a long term target of 100% MCT, and is currently building capital to meet that target. SGI's approach is reflected in its 2015-16 Annual Report (CAC Exhibit #18):

> ***Capital adequacy speaks to the Auto Fund's ability to honor its financial obligations. An adequate balance in the Rate Stabilization Reserve (RSR) gives the Auto Fund a financial resource to draw on when adverse events increase the costs of claims, thereby protecting customers against unpredicted premium increases for their auto insurance.*** *The Auto Fund uses a common property and casualty industry measure called the Minimum Capital Test (MCT) to monitor the adequacy of the RSR. The MCT is a risk-based capital adequacy formula that assesses risks to assets, policy liabilities and off balance sheet exposures by applying various factors to determine a ratio of capital available over capital required. The Auto Fund's 12-month rolling average MCT score of 95% was above the 2015 target of 69%, but remains below the long-term goal of 100%. At March 31, 2016, the actual, non-rolling MCT was 99%.*
>
> *The Auto Fund's 2016-17 target is an MCT of 90%. This target is lower than its final 2015-16 result as it was set during the Auto Fund's corporate budget process, prior to knowing final results. The Auto Fund will continue to focus on moving towards its MCT target of 100%, as described in the following section, Capabilities to Execute Strategies, under Capital and Liquidity.*
>
> [Emphasis added]

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[153] T: 231, 11-24
[154] CAC Exhibit 27: slide 179

235 As the Board witnessed throughout this hearing, the Corporation's performance is often compared to SGI and ICBC. Whereas the proposed 100% MCT **upper limit** gives the Corporation flexibility, it still leaves MPI at a significant comparative disadvantage to these other public insurers when it comes to having the ability to manage volatility and generate investment income beyond that required for matching claims liabilities. The reserve policies of other public insurers place them in positions of greater financial stability than the Corporation is presently permitted to attain, or will attain even under MPI's proposal.

236 It was suggested to Mr. Johnston that using 100% MCT meant that the odds that capital would be exhausted were less than 1 in 5,000.[155] There are two responses to this line of inquiry. First, Mr. Johnston indicated that this was understating the issue[156]:

> *There's other risks that we may not be able to model with a lot of certainty that the MCT would pick up for us.*

237 He also advised that using 100% MCT as the upper limit would be consistent with other jurisdictions.[157]

238 The DCAT as set through the collaborative process does not capture all the risks that could lead to an extreme event, and the MCT is an external indicator of capital adequacy that will account for additional risks that are not modeled in the DCAT.

239 Second, this is looking at the issue incorrectly. MPI is seeking to avoid a scenario where capital is rebated, only to have to seek an RSR rebuilding fee in subsequent years. Thus, relevant analysis is whether an event could occur that causes capital to fluctuate such that it could exceed the maximum then fall below the minimum

[155] T: 407, 16-23
[156] T: 410, 14 -21
[157] T:410, 14-21

threshold without management action. MPI stated as follows in the response to Undertaking #3[158]:

MPI respectfully suggests that, when looking at the upper RSR target, the analysis in this undertaking is not the most pertinent inquiry. MPI views that the relevant capital depletion scenario to consider in this exercise is the depletion of capital down to the lower RSR threshold (not zero), which triggers a rebuilding fee, and contributes to rate volatility. The scenario MPI seeks to avoid is a rebate to customers in a given year, bringing capital down to 100%, followed by a significant depletion of capital in the ensuing year(s) to require a rebuilding fee to meet the minimum threshold.

The probability of this depletion should be considered absent management action, as an RSR rebuilding fee would not be sought when capital levels are above the minimum threshold. MPI has calculated that the four year scenario that depletes total equity from $411 million (100% MCT) to $159 million is a 1-in-49 year scenario. That scenario is significantly more likely than a total depletion of capital, and also more germane to the purpose of the upper RSR threshold

240 The Corporation also notes that Dr. Simpson and Ms. Sherry concurred with the views of MPI as articulated in Undertaking #3[159]:

MS. KATHLEEN MCCANDLESS: Diana, can you, please, pull up MPI Exhibit number 62? I don't 1 know if either of you have had occasion to consider MPI's reply to Undertaking number 3 but MPI was asked to advise at what percentile level Basic total equity was exhausted in the simulations. So it – it addressed the estimated probability levels of adverse scenarios necessary to exhaust various Basic total equity levels. The last paragraph at page 1: "MPI opines that the relevant capital depletion scenario to consider in this exercise is the depletion of capital down to the lower RSR threshold, not zero." Would either of you care to respond to MPI's position on this question?

[158] MPI Exhibit 62: pages 1 - 2
[159] T: 2097, 24-2099, 12

(BRIEF PAUSE)

DR. WAYNE SIMPSON: Yeah, I -- I think I would agree with this. Once -- once you reach the - the lower threshold, whatever that is, they talk about a target minimum, I talk about a target midpoint and then define what minimum and maximum might reasonably be but, yeah, below the target minimum you have to start thinking about a rebuilding fee or an offsetting of premiums -- an addition to premiums, and then when you reach the maximum you have to think about a rebate which would offset the -- the premiums.

MS. ANDREA SHERRY: Yeah, I would agree --

DR. WAYNE SIMPSON: That -- that's the way I've conceived the RSR.

MS. ANDREA SHERRY: Yeah.

MS. KATHLEEN MCCANDLESS: And, Ms. Sherry, I hear you saying you agree with Dr. Simpson?

11 MS. ANDREA SHERRY: I do. I agree with those comments, yeah.

241 Mr. Johnston and Ms. Reichert expressed the same point as follows[160]:

So the DCAT is, again, some of the scenarios are kind of watered down a little bit, to use that word. There's in all these management action assumed. It's as low as I would sign off on as an actuary. I can't imagine signing off on a lower number.

That is the minimum amount we need to have in there. And from that perspective, we're taking as -- as little as possible from the ratepayers to -- to stay above that minimum. If we, through luck, because we're -- I say through luck, because we're targeting to break-even every year, if through luck we are able to build additional monies beyond the 159 million, we are just asking that we not rebate those funds unless we reach the upper 100 percent MCT target, which will allow us to manage variability and rate stability in a band between that absolute minimum and the MCT target.

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[160] T: 412, 12 - 414, 8

So for that reason I don't see the -- the 100 percent MCT as taking more than -- than we need to, I guess, be financially responsible and -- and maintain rate stability for the RSR purpose.

MS. HEATHER REICHERT: And if I may just add to that, so if you look at the range from the minimum based on the DCAT of a hundred and fifty-nine (159) to the maximum based on the minim -- or based on the 100 percent MCT, the -- the range in there is about 250 million.

So to what Mr. Johnston said, that two hundred and fifty (250) bandwidth, if you will, would allow for having net losses. So if you look at the last two (2) years we had net losses in Basic of almost 150 million. And depending on how this year comes to a conclusion, depending on what the winter is like this year, we could experience another $75 million loss in Basic.

So in three (3) years that's a $225 million loss. By having a bandwidth, if you -- if we were close to the -- the maximum RSR range, having that two hundred and fifty (250) bandwidth would mean that we are still within our range and not having to look to have an RSR rebuilding fee. So to -- to just accentuate the point that Mr. Johnston made, that minimum to that maximum we believe gives an appropriate bandwidth to allow us to manage and not have volatility in the rates or having to -- to ask for RSR rebuilding fees.

6.4 MPI Response to CAC's Position on the RSR

242 CAC has brought before the PUB, conflicting recommendations on the RSR.

243 Dr. Simpson has brought a proposal to both narrow and lower the RSR band[161]. Mr. Viola on the other hand has brought a proposal that would see MPI abandon its long standing focus on rate stability, pursue an investment strategy to target fund growth, adopt a capital reserve that would support that fund growth goal (i.e. a higher and wider RSR), and use rates as a balancing mechanism[162] outside that range. The Corporation has taken issue with various aspects of these proposals

[161] CAC Exhibit 26: slide 8
[162] T: 1960, 10 - 20

throughout its Closing Argument, but this is a clear instance (among many) of the CAC wanting their proverbial "cake and eat it too".

244 In its closing argument, the CAC emphasized that the MCT test is a solvency test.[163] This point is not in dispute. The CAC fails to recognize that the DCAT is also an insolvency test, a fact evident on its face, and confirmed by PUB counsel in cross examination.[164]

6.5 Closing Remarks on RSR

245 MPI submits that certainty is important when it comes to the RSR purpose and parameters. The amount of capital one holds is fundamental to corporate decision making, and it is particularly important for an insurance company that is exposed to significant uncertainties. We made significant progress in last year's Order with the move to risk based RSR thresholds, but the outstanding matters are an impediment to moving forwards. One area where this is particularly important is in investment strategy, discussed next. MPI is respectfully looking to the Board to bring closure to the remaining issues around the RSR.

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[163] CAC Exhibit 27: slide 165 -167
[164] T: 1760, 11-15

7.0 Investment Strategy

246 MPI commissioned AON to do an ALM study in 2014. MPI filed that ALM study last year, and this year Ms. Spiropoulos has attended to speak to AON's study at the Board's direction. Her evidence, and the materials prepared by AON, demonstrates that AON conducted a comprehensive study that generated appropriate results that were capable of being implemented by MPI.

247 MPI's investment objectives and the constraints imposed on the ALM study, rather than how AON conducted the study, were the focus of CMMG and CAC in the hearing. CMMG appears to expect higher investment returns. CAC has presented evidence of Mr. Viola, who characterizes MPI's focus on rate stability as a "problem" and identifies investment considerations premised on that view. MPI submits that the optimal portfolio must be defined with respect to the objectives and circumstances of MPI, and not in the abstract. Rate stability is valued, and has formed the basis of ratemaking since the Kopstein Report three decades ago. MPI's portfolio is optimized for a line of business that remains subject to significant uncertainty in terms of rate adequacy (the SIRF) and the parameters of the RSR. It is not realistic to "have one's cake" (high investment returns), "eat it" (rate stability), "eat it again" (minimal capitalization) and then "eat it one more time" (advocate for SIRF-based rates that are likely to be deficient).

248 In this section, MPI expands on the following points:

a. The Minister of Finance is ultimately responsible for MPI's investment portfolio, and neither MPI nor the PUB can direct investment strategy.

b. The Minister of Finance has the benefit of a wide variety of professional advice in managing the portfolio.

c. The Corporation's current investment strategy is designed for the needs and circumstances of the Corporation, including: (i) MPI needs to mitigate interest rate exposure on claims liabilities, and (ii) ongoing uncertainty around rate adequacy and capitalization have otherwise militated against a higher growth/higher risk investment strategy.

d. MPI and Ms. Spiropoulos of AON have provided persuasive responses to each of Mr. Viola's recommendations.

7.1 Government is Responsible for Investment Portfolio

249 Although the Corporation and the Department of Finance jointly advise the Minister of Finance on the investments, the Minister of Finance is ultimately responsible for the Corporation's investment portfolio. Neither MPI, nor the PUB, can unilaterally direct investment strategy. The PUB's consideration of MPI's investments must account for the limits on the Board's jurisdiction.

250 Pursuant to section 14 of *The Manitoba Public Insurance Corporation Act* all moneys acquired by the Corporation are deemed to be the property of Her Majesty in right of Manitoba. Section 12 of that Act requires the Corporation to pay to the Minister of Finance all the moneys that are in its reserves so that the Minister can invest those moneys. These moneys form part of the government's Consolidated Fund and are to "be invested in accordance with *The Financial Administration Act*."

251 The Minister of Finance is thus responsible for investing the moneys of the Corporation. The Board has no jurisdiction to issue orders that would purport to fetter the Minister's discretion in how these moneys are invested.

7.2 Competent Advisors to the Minister of Finance

252 The Minister of Finance has the benefit of a wide variety of professional advice in managing the portfolio. The portfolio is managed based upon the advice of an Investment Committee Working Group consisting of senior officials in the Department of Finance and the Corporation, professional investment managers and independent consultants such as AON who are hired from time to time to provide

specific advice.[165] These advisors have an in-depth understanding of MPI's business and constraints.

253 Mr. Viola is also an expert. However, given his more limited understanding of the Corporation, has been unable to give his theoretical advice real practical relevance.

254 The disconnect between the theoretical approach adopted by CAC and its advisor and practical relevance was exemplified in the following exchange between Mr. Williams and Ms. Reichert. Nobody disagrees that a rational investor should seek an "efficient portfolio" on the "efficient frontier." The issue, as Ms. Reichert identified, is that MPI's efficient portfolio is one that reflects the risks associated with having low RSR thresholds and uncertainly in the rate setting process[166]:

> *MR. BYRON WILLIAMS: Okay. And let's not assume I'm a rational investor, but if -- to the extent that there is a rational investor, portfolio theory suggests that a rational investor would only choose a portfolio from among those that are efficient, agreed?*
>
> *MS. HEATHER REICHERT: It -- yes -- yeah, like it depends on the risk tolerance, I think, of the particular investor. So as an example at MPI3 we don't have -- I'll -- I'll use the analogy. If you have a lot of money in the bank in your savings account, and it's invested in an efficient portfolio, and you have -- you have a windfall of -- of -- maybe you get a bonus unlike employees at MPI, and based on the fact that you have sufficient money in savings that you're comfortable with that is -- is being invested prudently, that bonus you may, therefore, be able to take on more risk and invest it in something that is going to potentially give you a much higher return but potentially also not generate that high return and -- and you could lose that investment. But you're willing to take on that risk because you have the capital reserve in the bank at the time.*
>
> *So at -- at MPI because currently, and at the time that we did the ALM study our RSR reserve was in the 10 to 20 percent of written premium range, not based on risk factors specific to the Corporation. That resulted in us not having*

[165] MPI Exhibit 1: Volume II, Attachment A, PDF page 7
[166] T: 845, 21-848, 5

enough money in the bank to be able to take more risk with the investments that -- that we were making.

So that very much impacted the Aon asset/liability management study that was done where we absolutely could not afford to take on significant risk and potentially lose more of what was already a very small capital amount that we had.

MR. BYRON WILLIAMS: Ms. Reichert, thank you for that answer. Just to go back to the question, I -- I think what you were saying is that among that frontier or family of efficient portfolios, the optimal portfolio chosen by any particular investor or corporation is determined by that individual's preference for trading off greater return against more risk, assuming a rational investor.

MS. HEATHER REICHERT: Correct. So a rational investor will make their determinations based on the risk that they are comfortable in taking. And my example was to show that often the amount of risk that you're able to take is directly related to the amount of savings or capital that you have in the bank at the time that you're making this decision.

255 As discussed below, Mr. Viola's recommendations repeat similar "motherhood" principles to those articulated by counsel for CAC in the passage above.

7.3 Investment Strategy Reflects MPI's Current Circumstances

256 Investment strategies must be designed for the individual needs and circumstances of the investor.[167] The Corporation's current investment strategy is designed for the needs and circumstances of the Corporation. Two key realities are that (i) MPI needs to mitigate interest rate exposure, and (ii) ongoing uncertainty around rate adequacy and capitalization have otherwise militated against a higher growth/higher risk investment strategy.

[167] T:1885, 14-16

7.3.1 Reality #1: Need to Limit Exposure to Interest Rates (ALM)

257 The current overriding investment objective, reducing exposure to interest rate changes on claims liabilities (referred to as Asset Liability Management, or "ALM"), is appropriate. It is consistent with the Board's prior pronouncements, and addresses MPI's own concerns regarding interest rate exposure.

258 The Board, in Order 135/14 at page 39, stated:

> *The Board identified the interest rate risk faced by MPI last year and stated in Order 151/13, on p. 32:*
>
> > ***It is the view of the Board that the Corporation's current approach to duration mismatching makes it too vulnerable to interest rate risk. The Board believes that the Corporation should match exposures, including cash flow, beyond duration matching on a go-forward basis.*** *The Board directs MPI to submit a discussion paper of the duration matching of its claims liabilities and investments as part of the next GRA.*
>
> *MPI provided a Duration Matching Discussion Paper in which it evaluated the interest rate risk faced by MPI. MPI found that the interest rate risk to the Corporation is more significant with a larger duration bandwidth. MPI analyzed the impacts of both a 1% increase and a 1% decrease in interest rates. MPI found that in a 1% interest rate increase scenario, changing the duration gap from -2 to -1 years reduced the positive impact on Basic net income from $42.8 million to $37.9 million, a $4.9 million difference which represents a reduction in gains or, expressed otherwise, the opportunity cost of reducing the duration gap in a rising interest rate environment. In a 1% interest rate decrease scenario, changing the duration gap from -2 to -1 years reduced the negative impact on Basic net income from ($57.2) million to ($40.7) million, reducing the downside net income impact or loss by $16.6 million. In other words, losses from the mismatch when rates are falling exceed the gains when rates are rising.*

> *As a result of this analysis, the Corporation's Investment Policy Statement which previously allowed for a duration mismatch of up to +/- 2 years was changed to +/- 1 year on or about August 31, 2014. MPI has characterized this change as a stopgap measure pending the completion of the ALM Study underway currently, which study will address the merits of cash flow matching within the Corporation.* ***The Board orders MPI to file the ALM Study with the Board at next year's GRA together with its proposed course of action at which time the merits of cash flow matching will be discussed.***
>
> *As such, MPI continues to position itself such that the average duration of bonds is less than the average duration of claims liabilities because it expects that interest rates will increase. This means that an increase in interest rates will benefit Basic's net income, because the drop in value of marketable bond investments will be less than the decrease in value of discounted claims liabilities.*
>
> [Emphasis added]

259 The objective of reducing exposure to interest rate movement is key for a property and casualty insurer like MPI. In the absence of MPI's actions to match liabilities, MPI would face significant risk of financial losses. MPI undertook an ALM study to reduce the exposure of the claims liabilities to interest rate movement.

260 MPI followed Aon's recommendations when it came to the type of matching (duration, hybrid, cash flow). Aon recommended duration matching. It had determined, based on its modeling that more precise forms of matching provided insufficient benefit to compensate for the lower portfolio returns.[168] As a result, MPI matches the duration of the fixed income portfolio to the duration of the claims liabilities (within 0.25 years).[169]

261 In order to meet the objective of matching investments to the claims liabilities approximately 70% of the portfolio must be held in bonds. The percentage held in

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[168] T: 1212, 3- 7
[169] MPI Exhibit 1: Volume II, Attachment B: Operational ALM Policy, page 1

bonds is driven by the amount of claims liabilities.[170] This has the effect of limiting the size of the portfolio that can be invested in potentially higher yielding/higher risk investments to 30%.

7.3.2 Reality #2: Ongoing Uncertainty on RSR and Rate Adequacy Makes it Difficult to Justify Assuming More Investment Risk

262 MPI was asked why it wasn't at least allocating more of the bond portfolio to corporate bonds (higher yield/higher risk). Ms. Reichert pointed out that taking on more risk in the bond portfolio was not appropriate when MPI lacks confidence in its ability to absorb losses[171]:

> *MS. HEATHER REICHERT: No, we haven't at -- at this juncture increased any -- any of our investments in corporate bonds. One of the -- one of the reasons why we weren't more into corporate bonds in the past is that they are seen as a higher risk fixed income investment.*
>
> *And so we really -- in order to take on more risk in our investment portfolio we need to have the comfort of a -- of a certain amount of agreed upon capital reserve within the Corporation because obviously the more risk that you take on in your investments the more potential you can lose You can gain more, but you can also lose a lot more.*
>
> *And we need to have the comfort of that range within the RSR to allow for the fact that by investing in -- in higher risk instruments that -- that we've got savings in the bank, if you will, that -- that capital reserve, in order to offset should -- should corporate bonds decrease in value more significantly than -- than say the MUSH bonds.*
>
> *So we had viewed that we had MUSH bonds that gave us a higher return somewhat similar to what a corporate bond would give us as a higher return, only their -- of course their value doesn't change whereas the corporate bond value can -- can fluctuate, and that causes a risk of -- of loss.*

[170] T: 446, 1-10
[171] T: 447, 8 - 448, 18

MS. CANDACE GRAMMOND: So can we expect to see corporate bonds in the portfolio next year?

MS. HEATHER REICHERT: Part of that -- part of that depends on having the -- the appropriate RSR range that we feel that we need to -- in order to mitigate the risk of our investment portfolio. So assuming that that occurs then, yes, I -- I, yeah, think you -- you will see some more corporate bonds in the fixed income portfolio.

263 The allocations within the growth portfolio, and in particular the decision not to include any international equities, which only appeared in Aon's most risky portfolios, similarly reflects MPI's limited ability to assume greater risk.

264 Aon elaborated on their recommendation of portfolios[172]:

In terms of the asset mix, based on the objectives that we discussed with MPI, they – we perceived that their risk tolerance was low given that they do have the mandate to breakeven instead of targeting a profit. There is an extensive process to change the targeted levels of reserve. And MPI does not have direct control over the premium rates.

So we recommended adopting portfolio 2 in the study because it is at the lower end of the risk spectrum.

265 As reflected in Ms. Reichert's comments (quoted above), a significant source of MPI's reticence is the continued uncertainty around premium adequacy and capitalization. The Corporation's concern is justified. The RSR is still being debated after a number of years. As Mr. Johnston articulated, the current minimum RSR target reflects an aggressive 1 in 40 scenario based on a watered down version of the DCAT analysis that removes adverse historical data and incorporates significant assumptions about management action. Interveners are seeking to lower the RSR level at which rebates are considered. Dr. Simpson and Ms. Sherry are again advocating setting the lower threshold as low as 1 in 10, essentially meaning that MPI should anticipate being insolvent once every decade even with rate increases.

[172] T: 1212, 8 - 17

MPI just experienced a circumstance similar to a 1 in 40 event that required capital transfers of $148.2 million over two years. The SIRF is still posing a risk of significant rate deficiencies.

7.3.3 Realities Make Comparisons to Other Portfolio Returns Not Meaningful

266 MPI's portfolio performance to the performance of other funds, whether those funds are other Manitoba institutions or other insurers like SGI, is an exercise of comparing "apples to oranges". MPI's portfolio returns reflect the risk-reward trade off suitable for MPI, which may differ materially from the risk tolerance of other institutions.

267 For example, while the liabilities of the WCB and MPI are similar there are significant differences between the two organizations and the nature of their risks. The WCB sets its own rates and it determines the target level for the Accident Fund Reserve and when rebates or surcharges are required. In the case of the Corporation, these decisions are made by the Board. Ms. Reichert observed that organizations with greater capacity to bear losses can invest more in corporate bonds and international equities.[173]

7.4 Response to Mr. Viola

268 Mr. Viola is, like Aon/Ms. Spiropoulos, a very capable and qualified investment expert. However, Mr. Viola is not familiar with MPI, the applicable accounting and actuarial standards, and the history that underlies the current ratemaking approach. His recommendations all come from the starting point that the way in which the PUB has deliberately chosen to set rates for three decades – specifically the focus on shorter term rate stability - is a "problem". Some of the specific recommendations he has made are divorced from the practical realities of accounting standards and actuarial standards applicable to MPI. Other recommendations have already been reflected in the AON study, are under consideration by MPI, or have no material impact. MPI respectfully submits that

[173] T: 464, 6-466, 6

the Board should continue to value rate stability, and that the Minister is well positioned to make investment determinations based on input from his/her own professional advisors.

7.4.1 Rate Stability is a Virtue, Not a Problem

269 The most fundamental issue with the approach advocated by Mr. Viola is it is premised on the long-standing objective of rate stability being a "problem".[174] All of his other recommendations flow from this starting premise, and are directed at "symptoms" of the underlying "problem".

270 Mr. Viola's presentation, e.g. slide 3, lays out this view. He elaborated[175]:

> *...**what matters most is the long-term sustainability of the plan and that that should be the primary risk and goal, but that's not for me to decide**.*
>
> *But if that's the chosen one, then I would say -- I would say that you work backwards and you say, What's the right thing to do? **Best metrics for purposes of long-term portfolio asset mix choices, and then decide**, okay, in parameterizing, setting the limits for the rate setting process and the buffers that are dependent on it**. Select your reserves that you're comfortable with based on the metrics that you choose**, and then set the boundaries, the min /max, based on those metrics.*
>
> *So if you choose a different thermometer, then give guidance on what the readings will be for what's cold and too high -- too hot, for example. **So I would say the short-term rate setting metrics should be not driving the process, they should -- you should use that as the balancing mechanism** after you determine what the best portfolio design is on average for the fund to achieve sustainable levels of reasonable rates without long term risk to that.*
>
> [Emphasis added]

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[174] CAC Exhibit 24: slide 3
[175] T: 1960, 1-22. See also, T: 1893, 1-20

271 Mr. Viola's views on priority of goals may be appropriate for pension fund management, but MPI is a rate regulated entity. Rate stability matters. That objective is reflected in the Kopstein Report. It is reflected in the name "Rate Stabilization Reserve", and its use. It is reflected in the PUB's rate capping mechanisms. There is no justification to turn the business model on its head.

7.4.2 Mr. Viola Deferred to Fiduciaries on Key Matters

272 A recurring theme in Mr. Viola's recommendations is that ultimate implementation should be deferred to the fiduciaries who oversee the portfolio, be it determining the appropriate approach to risk management[176], inclusion of international equities[177], approach to quantitative modeling[178], the inclusion of RRBs[179], the approach to duration policy.[180]

273 The team of investment professionals who oversee the investment portfolio, including MPI, the Department of Finance, individual fund managers, and AON are each well qualified, highly trained and competent to perform their respective roles.

7.4.3 Portfolio Recommendations are Theoretical

274 Mr. Viola's portfolio recommendations were focused on Canadian equities, international equities and Real Return Bonds (RRBs), and informed by his view regarding the primacy of long term investment objectives. They are addressed below.

[176] T: 1898, 2 - 1901, 14
[177] PUB(CAC)1-4: page 18
[178] PUB(CAC)1-4: page 18
[179] PUB(CAC)1-4: page 19
[180] PUB(CAC)1-4: page 20

7.4.3.1 Aon Considered Canadian / International Equities

275 Mr. Viola identified the absence of international equities in MPI's portfolio as a "symptom" of the underlying "problem". The same is true for the amount of Canadian equities in MPI's portfolio[181]:

SYMPTOM		
	PUCK HOG	**Canadian Equities** • Larger-than average home bias • Concentrated sectors/stocks
	SHORT-HANDED	**No International Equities** • Missed opportunities to add value, diversify portfolio

276 International equities were not "missed". AON, when it 'got into the weeds'[182], considered international equities in its modelling. Aon concluded that the portfolio with international equities was too risky for MPI, given its circumstances. Aon also considered the impact of re-allocating Canadian equities to international equities. The results were unfavourable[183]:

> All asset classes and constraints are reviewed each time an ALM is completed to ensure they align with the organization's objectives. When choosing asset classes for the ALM, the organization needs to ensure it is comfortable with the asset class modeled and can effectively implement it. It is generally recommended that a minimum of 5% be allocated to an asset class in order to achieve a meaningful impact on risk and reward and manage costs.
>
> International equities were modeled as part of the ALM but only showed up in riskier optimal portfolios. It is important to note that Canadian and U.S. equities were modeled with allocations to small capitalization equities which reflected MPI's plans for implementation. This improved the risk-reward profile of these asset classes.
>
> Aon's response to Question CAC 82B provides analysis on the impact of moving 1%, 5% and 10% from Canadian equities to international equities. This analysis indicates that reducing Canadian equities and increasing international equities increases risk and does not improve reward.

[181] CAC Exhibit 24: slide 3 (excerpt)
[182] T: 1904, 24
[183] PUB Pre-Ask #2: page 9

277 Mr Viola's recommendation on International equities was not supported by quantitative evidence, and in any event, he defers responsibility for the practical implementation to MPI and the Department of Finance.[184]

7.4.3.2 Real Return Bonds Are Too Costly

278 Mr. Viola advocates the use of Real Return Bonds (RRBs) in MPI's portfolio, characterizing their absence from MPI's portfolio as another "symptom"[185]:

SHAKY GOALIE	**No Real Return Bonds** • Poor liability protection against unexpected inflation, <u>real</u> rate risk • Less effective duration management

279 Mr. Viola used a basketball analogy of a team being better off with having a five foot point guard, and seven foot forward (where, it is understood, that the forward represents higher return growth assets, and the point guard represents low return RRBs), rather than five mid size players. The problem with this analogy: point guards (RRBs) are too costly at present for the type of benefit they offer.

280 RRBs are, by Mr. Viola's own admission, a costly form of insurance against inflation[186]:

> *MR. MATT GHIKAS: And right now it is expensive insurance, correct?*
>
> *MR. VALTER VIOLA: I -- the quick answer is, yes, it is from a historical perspective.*

281 Current inflation is low, and inflation expectations are uncertain. Mr. Viola even suggested that "there may be deflation, but -- so who knows what the optimal one

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[184] PUB(CAC) 1-4: page 19
[185] CAC Exhibit 24: slide 3 (excerpt)
[186] T: 1921, 9-12

is?"[187] Indeed, inflation may accelerate, but under the current circumstance, the costs cannot be justified. The low return on RRBs would (i) reduce the portfolio return and (ii) negatively impact the claims discount rate[188]. The adoption of RRBs would require further increases in premium rates above the proposed 4.3% combined rate increase.

282 Mr Viola's recommendation on RRBs was not supported by quantitative evidence, and in any event, he deferred responsibility for the practical implementation to MPI and the Department of Finance.[189]

283 There is also an inconsistency between advocating for expensive RRBs to hedge against inflation, and neutering the DCAT inflation scenarios by removing the periods of higher inflation before 1990. If the interveners and PUB consider the risk of inflation to be real, then the DCAT scenarios that assume marginal inflation risk should logically be re-considered.

7.4.4 Evolved Risk Framework: Same Stuff, a Little Different

284 Mr. Viola further advocated that MPI should adopt an 'evolved risk framework'[190], which he referred to at the hearing as risk budgeting. During cross-examination, it became clear that the process Mr. Viola was contemplating was not all that different from what is in place. He characterized it as[191]:

> *just another name for something that they do to – to a lesser degree or in a different way.*
>
> *So I would argue that it's just a synonym for portfolio management, risk management with greater transparency frequency in risk terms.*
>
> *... it's the same old stuff viewed a little differently*

[187] T:1966, 9-10
[188] T: 1934, 3-5
[189] PUB(CAC) 1 - 4: page 20
[190] CAC Exhibit 24: Slide 26
[191] T: 1905, 25-1906, 17

Aon didn't disagree with Mr. Viola that risk management is important, but noted (correctly) that the recommendation was insufficiently specific to comment on in any detail. Aon also observed that the practical implications must be considered.[192] Those practical considerations did not feature in Mr. Viola's evidence.

7.4.5 Mr. Viola's Other Recommendations

285 Mr. Viola made a number of other recommendations. MPI responded to each of them in Rebuttal Evidence. Aon responded in PUB Pre-Ask 2.[193] Mr. Viola backed away from the recommendations that were at odds with accounting and actuarial standards. MPI agreed that some should be considered in the next ALM study.[194] Some recommendations were very generic ("no over-reliance on quantitative modeling"), or had otherwise been considered already.

7.5 Next Step is Adequate Rates and Predictable Capitalization, With ALM Study to Follow

286 MPI undertakes ALMs on a periodic basis, and has one scheduled. In the meantime, MPI's investment portfolio is actively managed and subject to careful scrutiny by qualified professionals who consider the circumstances facing MPI. Conducting another ALM right now is premature.

287 The three main inputs into an ALM study are risk (standard deviation), return and correlations for each asset class. Ms. Spiropoulos noted in answering questions from CAC Counsel[195] that volatilities tend to be pretty stable over time, that correlations also tend to be reasonably stable over time, and that while return expectations in absolute terms may change this may not lead to a material changes to decision in the relationship between assets. MPI submits that, as the risk and correlation assumptions are generally stable, the factors that change ALM outputs are the constraints imposed to reflect objectives and risk tolerance. This underscores why the RSR thresholds and interest rate forecast need to be nailed

[192] PUB Pre-Ask 2: slide 7
[193] PUB Pre-Ask 2
[194] MPI Exhibit 20: page 9
[195] T: 1301

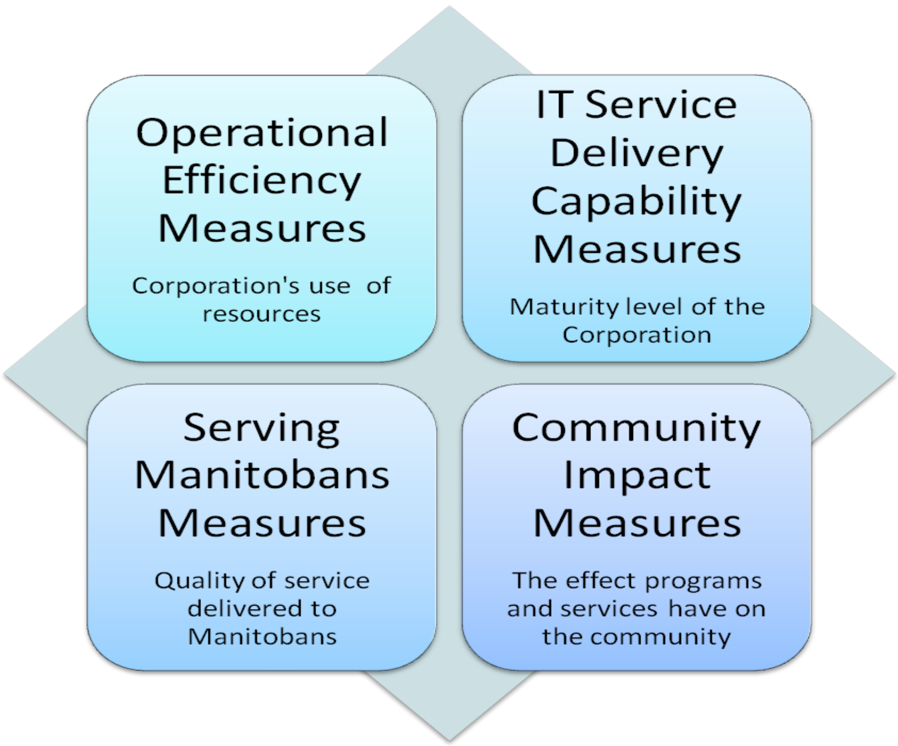
down first. It also underscores why the push by interveners to rely on the SIRF, minimize capital reserves and narrow the RSR range only make it more difficult for MPI to entertain assuming greater investment risk in a quest for higher returns.

288 Approving MPI's requested proposals will position the Minister of Finance and MPI to give further consideration to investment strategy in the future. There is no value in undertaking a costly ALM study or in revisiting its investment objectives while so much uncertainty remains regarding two foundational elements of MPI's business, i.e. MPI's capitalization and rate adequacy.

November 4, 2016

8.0 Benchmarking

289 MPI employs annual Benchmarking to determine the Corporation's performance relative to other companies. The Benchmarking is focused on four main areas:



290 MPI uses the benchmarking results to identify opportunities to reduce costs, effective management approaches, and efficient resource allocation. Benchmarking also provides important information to equip MPI to focus on top priorities, understand the macro-economic context, support risk management and manage regulatory requirements.[196] In PUB Order 128-15, the Board acknowledged that

[196] MPI Exhibit 1: Volume I, BMK.7, page 15-18; see also T: 654, 20-655, 4

MPI has made progress with benchmarking including presenting its benchmarking framework to the Board.[197]

291 MPI makes the following points in this section:

a. MPI benchmarks well on operational efficiency.

b. MPI has been making steady progress on IT benchmarking and outperforms its peers in key respects.

c. MPI is perceived as providing quality service to Manitobans.

d. MPI's impact on communities is acknowledged and valued.

8.1 MPI is Operationally Efficient

292 Operational efficiency measures MPI's capacity to deliver high quality products, services and support in the most cost-effective manner possible.[198] MPI has performed well.

293 MPI engaged the Ward Group to provide an independent perspective on how the Corporation compares to other companies, identify and prioritize improvement opportunities, set performance expectations and monitor performance. Ward identified the most meaningful indicators of operational efficiency for corporate performance, and claims performance.

294 MPI performed well against the benchmark groups in many operational efficiency measures, which confirms that the Corporation is operating efficiently and effectively. As noted by Ms. Reichert in her presentation[199]:

> *So we're -- the -- basically, it's showing we're relatively stable and -- and in some cases quite significantly lower than the Canadian benchmarks with respect to overall corporate performance, claims performance, and then staff efficiency.*

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[197] PUB Order 128/15: page 5
[198] MPI Exhibit 1: Volume I, BMK.7, page 19
[199] T: 269, 3-8

295 MPI's is outperforming peers by a wide margin in two key operational metrics:

	MPI	CDN Benchmark
Gross expense per policy in force	$286	$490
FTEs per 100,000 Reported Claims	548	1281

296 The macro-mandate measures show that:

a. Manitobans paid less for their automobile and motorcycle insurance in 2015 than most major Canadian cities [200]

b. MPI has exceeded expectations by returning between 93-114% of every premium dollar earned [201]

c. Since 2000/01, Manitoba's premium growth has grown at a consistently lower rate compared to other Canadian auto insurers and the national average [202]

297 In short, the benchmarking tells a very favorable story with respect to MPI's operations.

8.2 IT Service Delivery

298 MPI's performance relating to IT Service Delivery is addressed in Section 9 of these Closing Submissions. The evidence presented there demonstrates that MPI is making steady progress in this area and that MPI outperforms its peers in key spending and maturity metrics

[200] MPI Exhibit 1: Volume I, BMK.7.1, page 28
[201] MPI Exhibit 1: Volume I, BMK.7.1, page 32
[202] MPI Exhibit 1: Volume I, BMK.7.1, page 33

8.3 MPI is Serving Manitobans Well

299 Serving Manitobans monitors perceptions of MPI's products and services by eliciting feedback from customers and the general public. Overall results indicate that the Corporation performs very well in meeting Manitoban's needs.[203]

300 Public Perception is measured through a telephone survey of randomly selected Manitoba residents and residents from other Canadian jurisdictions on a biennial basis. Survey participants are asked to provide a description of their vehicle insurer and to give accounts of service and experience with their vehicle insurer.[204] MPI compares well to other public automobile insurers. It received only slightly lower scores than Saskatchewan Government Insurance (SGI) and much higher scores than the Insurance Corporation of British Columbia (ICBC).[205]

301 Customer Service Trending Measures assesses overall customer satisfaction through telephone surveys of randomly selected participants who have recently used MPI services from areas such as physical damage, personal injury and insurance and licensing.[206] MPI scored consistently high on satisfaction levels with services received.[207]

8.4 Favorable Community Impact Scores

302 Community Impact assesses perceptions of MPI as a corporate citizen and the impact of MPI's programs on road safety behaviors. Overall, MPI's community impact measures are favorable.[208]

303 MPI uses annual public polling of randomly selected Manitoba residents and residents from other Canadian jurisdictions to assess Public Perception

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[203] MPI Exhibit 1: Volume I, BMK.7.3, page 43
[204] MPI Exhibit 1: Volume I, BMK.7.3, page 43
[205] MPI Exhibit 1: Volume I, BMK.7.3, page 45
[206] MPI Exhibit 1: Volume I, BMK.7.3, page 44
[207] MPI Exhibit 1: Volume I, BMK.7.3, page 47
[208] MPI Exhibit 1: Volume I, BMK.7.4, page 48

Benchmarking Measures. The Corporation generally has a good relationship with the public, with public support from Manitobans of 71%.[209]

304 Road Safety Public Perception Measures are assessed through public polling of randomly selected Manitobans. Seven in 10 Manitobans surveyed said that MPI was successful in addressing driving safety problems in Manitoba.[210]

[209] MPI Exhibit 1: Volume I, BMK.7.4, page 50
[210] MPI Exhibit 1: Volume I, BMK.7.4, page 51

9.0 Information Technology

306 In this section, MPI elaborates on the following points:

a) the Corporation's IT budget is appropriate and focused on ensuring that the Corporation doesn't lose the valuable ground it gained from the ITO Initiative;

b) the Corporation has an appropriate governance and oversight structure in place, and projects are being managed appropriately;

c) the Gartner Report confirms that the Corporation has made significant progress and performs well relative to its peers on key benchmarks

9.1 IT Budget is Appropriate and Focused

307 MPI's IT budget reflects cost containment efforts and is focused on ensuring that the Corporation doesn't lose the valuable ground it has gained from recent optimization investments. IT costs are not driving the rate indication. Escalations in forecast budget must be understood in the context of IT investments the Corporation has made to overcome a technology deficit, and maintain the investment going forward.

9.1.1 IT Costs are Not Driving the Rate Indication

308 The Corporation has indicated that operating expenses are not driving the requested rate increase. This includes IT operating and implementation expenses related to IT initiatives. As shown in the schedule of Basic normal operating expenses in Volume II Expenses page 51, the average change in data processing costs and amortization and depreciation in the rating years is negligible. There is no impact on the requested rate indication. Similarly, the average change in implementation expenses is also negligible and has no impact on the rate indication.

9.1.2 IT Cost Containment

309 Cost Containment initiatives related to Information Technology (IT) include review of software expenditures, renegotiation of IT contracts, and the review and negotiation of data center operation spending. The outcomes include a reduction in licensing and software purchases, reductions in IT spending due to contract price negotiations and operation efficiencies that reduce data center requirements.[211]

310 In her testimony, Ms. Reichert explained future cost reductions associated with IT staff resources, specifically referring to Expense Appendix 7.2[212]:

> *So when -- when ex -- the 7.2 appendix was created, those -- the additions of staff relating to IT were not reflected in the compensation schedule. The reason for that is, we know that the transition from removing consultants and adding staff is going to take time. And so we know that in the initial -- in the initial phases of that we're not expecting any net dollar savings to occur, so we did not adjust the compensation schedule. And we minimally may have adjusted the consultant expense line in the budget. So that's how we had dealt with it because, at that time, we didn't know how many we would actually change into permanent staff and expected that there would be a period of time when we would have both permanent staff and consultants working side-by-side and, therefore, not -- not achieve any direct savings until starting in the second, and then fully in the third year.*

311 MPI's management of IT costs is reflected in the Gartner scorecard results, which are discussed later in this Section. MPI is at Gartner's target spending levels and is superior to its peers.

9.1.3 MPI's Focus on Maintaining IT Assets

312 As a result of public system outages that occurred in 2010, and as part of regular and ongoing internal reviews of IT systems and processes, the Corporation

[211] CAC (MPI) 1-36: page 2
[212] T: 558, 13 – 559, 5

embarked on the Information Technology Optimization (ITO) program. ITO addressed technology obsolescence at MPI, which had been created by not performing regular updates to various technologies thereby creating significant technical debt. Now that the ITO project is complete, it is important that the Corporation continues to invest in the maintenance of its technical assets to avoid falling into the same situation that required the ITO in the future.[213] This is the role of Technology Modernization, and it represents a significant portion of the IT budget.

313 After the completion of the ITO program, the following objectives were achieved:

- Identify and Eliminate Single Points of Failure; the review identified ten single points of failure which have all been addressed through the ITO Program.
- Implement Class 2 Disaster Recovery/Business Continuity Solution; MPI selected IBM as the data centre provider.
- Design, Build, and Commission a new data centre; the new IBM Data Centre built in Ontario offered the following benefits: quality, industry and technology expertise, adaptability and flexibility, risk management, and financial value.
- Renovate the existing data centers; the Cityplace and Plessis Road data centers were converted into communication hubs.
- Migrate data to the new data centre; the migration of data was completed on schedule.[214]

314 The following are tangible cost savings and benefits associated with the outsourcing of data processing to IBM[215]:

- Reduced Information Technology (IT) Risk through improved Information Technology Infrastructure Library (ITIL) process adherence to a mature IBM Incident Management/Change Management/Problem Management framework. This has improved availability metrics as well as improved response to outages

[213] MPI Exhibit 1: Volume 1, Information Technology, page 14
[214] CAC (MPI) 1-43
[215] CAC (MPI) 1-46

and in turn reduced impact on clients and customers. This also provides cost avoidance opportunities through quicker resolution of IT outages, better planning and scheduling of IT changes and reduction in recurring incidents.

- Improved IT Security Governance and Strategic Outlook. The Corporation implemented Information Security Controls (ISeC) to audit and maintain our secure environment. This also provides the ability to engage IBM in IT Security advisory services to assist Manitoba Public Insurance (MPI) in future IT security planning at no additional cost.
- Improved project delivery efficiencies in delivering IT Data Centre services through Time & Material costing model with IBM on all IT projects.
- Improved ability to fully manage all Data Centre services in a repeatable granular approach through detailed itemized monthly reports. This provides full visibility to all data centre services, hardware and software and allows MPI to operate as lean as possible and plan for future demand efficiently and in a cost avoidance manner.
- Guaranteed Data Centre Infrastructure health and currency at no additional cost through ever greening service that is baked into the contract. This improves MPI's ability to maintain high availability percentages and reduce risk without incurring additional costs.
- Continuous improvement and innovation opportunities within the Data Centre environment as part of yearly contract deliverables at no additional cost.

315 The Technology Modernization program, which represents a significant portion of the IT budget, consists of two initiatives; Technology Risk Management, and Technology Innovation and Capabilities.

- The goal of the Technology Innovation and Capabilities initiative is to implement initiatives which add new capabilities or expand existing capabilities to realize improvements, efficiencies or financial benefits. Prudent technology management requires a continual review of innovative emerging technologies and how they may apply to MPI's technical environment.[216]

[216] MPI Exhibit 1: Volume 1, Information Technology, page 19

- The goal of the Technology Risk Management initiative is to implement projects that will keep existing technology in a stable and supported state and address other technology risk through process and technology improvements.[217]

316 Ms. Reichert spoke about the Technology Modernization program, at a high level, as follows[218]:

Essentially what -- what the technology modernization program is, it'll be a variety of different projects, but the intent is that when we underwent business process re-engineering and the -- and, more specifically, the IT optimization project, which was a $45 million, I believe, capital project at that time, that was undertaken because, at the time, enough attention hadn't been spent on maintaining existing information technology infrastructure. It's like any other asset. It needs to be maintained in order to continue to function in the way that it needs to function. So we had what was described as roof repairs that were— you know, foundational roof repair kinds of things that were required. And that was the IT optimization project that helped get things well managed and well controlled. So that's been done.

And now in order to ensure that we don't get to a situation where the roof is leaking again, you need to have ongoing maintenance of that particular asset. So a large part of the technology modernization is ensuring that we are keeping the existing asset functioning properly.

317 For this type of modernization program, the return on investment is realized through risk reduction. This includes reduced risk of running on unsupported or outdated technologies and reducing risks identified in various risk assessments. Ms. Reichert responded to a request for quantifiable financial benefits of IT projects with the following[219]:

Given the nature, as I explained, what this project is set to do, it is essentially like ensuring that the roof is staying maintained, doesn't spring any leaks, if you

[217] MPI Exhibit 1: Volume 1, Information Technology, page 17
[218] T: 638, 19-639, 16
[219] T: 644, 9-25

will. So basically, its cost avoidance down the road from not having looked after your assets properly, and then incurring an even larger expenditure or renovation in the future. So there isn't specifically. Like there is for something like the PDR project, there isn't specifically identified cost savings from this. It's basically maintaining assets and avoiding significant costs down the road.

9.2 Appropriate Governance and Oversight: Value Management

318 MPI filed a conceptual IT Strategy document last year. Based on CAC's comments in a preamble to an IR this year, [220] the IT Strategy itself is not really an issue. The focus was more related to analysis and implementation. In this section, MPI outlines the evidence demonstrating that it has appropriate governance and oversight mechanisms in place for IT. MPI has clear accountabilities and uses a Value Management Process to define the expected benefits and the expected cost of new investments. The value management process also ensures that the expected benefits and costs are achieved after new investments are implemented.

9.2.1 Clear Accountability Through Value Management Process

319 The Value Management process makes the Business Transformation Office (BTO) ultimately accountable for IT projects.

320 The BTO performs preliminary assessments of the effort required to complete an initiative. The BTO is also responsible for executing approved initiatives in line with approved charters and budgets. It has its own Steering Committee. BTO also has an overall management team responsible for overseeing the execution of the portfolio of projects, including, Enterprise Project Management Office (EPMO) and Enterprise Portfolio Management Services (EPMS), Technical Architecture, and

[220] In its preamble to CAC (MPI) 1-47, CAC states: "The IT Strategy is a thoughtful, professional and well-crafted document, with a sound strategic focus, and one that makes many qualitative statements regarding a focus on realization of business value."

Business Architecture.[221] The roles of these teams, under the overall umbrella of the BTO, are as follows:

a. The Enterprise Project Management Office (EPMO) provides project management oversight and governance, and coordinates project reporting on all ongoing initiatives. It ensures that projects adhere to prescribed project management methodologies and standards and that expected benefits are realized.

b. Enterprise Portfolio Management Services (EPMS) provides financial oversight over BTO Operations, BTO Projects, and HP Statements of Work.

c. The Technical Architecture team ensures consistent project-to-project corporate-wide alignment of information systems technology with the help of its Integration Centre supported by teams of systems and data architects.

d. Business Architecture is the champion of all corporate projects and is the principal interface between the initiatives and the business community. Business Architecture has the authority to accept all deliverables and resolve all project issues.[222]

9.2.2 Defined Project Delivery Methodology

321 The BTO Project Delivery Methodology has a defined project lifecycle and helps guide projects through seven phases of project delivery. Each phase has a primary objective and critical milestones that denotes the objective being accomplished[223]:

1. *Inception – Achieve stakeholder consensus regarding high-Level Scope, Objectives, Timeline & Budget.*
2. *Business Elaboration - Develop a viable Plan and Business Strategy to build the system or business package through the definition of Business Requirements & Architecture.*

[221] CAC (MPI) 2-26
[222] CAC (MPI) 1-37
[223] CAC (MPI) 1 -37: pages 3 - 4

3. *System Elaboration – Develop a viable System Strategy to build the system through the definition of System Requirements & Architecture.*
4. *Build - Develop a high-quality system or business package.*
5. *System Testing – Validate the developed system components for promotion to an integrated User Acceptance environment.*
6. *Acceptance Testing – Validate that the final solution meets the business requirements and ensure the system or business package can safely and effectively be implemented.*
7. *Implementation and Warranty – Obtain the Project Stakeholder's Acceptance and Transition the Project to Operations.*

9.2.3 Business Cases and "Gating"

322 As part of Value Management, the business case process involves multiple iterations, with the first being a high-level presentation of the concept. If the concept is approved, additional time would be spent further investigating and documenting the costs, benefits, risks, etc. of the project. This iterative process continues until the appropriate amount of diligence has been applied to the initiative and an informed decision can be made to proceed or not with the project based on the best information available at the time. The number of iterations is typically dependent on the magnitude of the initiative being considered. Once projects are approved and implemented the process enables benefits realized to be measured against the original project objectives.[224]

323 Mr. Geffen emphasized the significance of MPI's use of a gated approach. Mr. Geffen commented on IT governance, regarding the "gated approach" [225]:

So we think that the -- the -- one (1) key area is having key inputs from business stakeholders at all levels. So certainly you'd want to have business stakeholders involved at an executive level as you're starting to look at opportunities and -- and look at priorities and having them – having stakeholders, business stakeholders involved at management and operating

[224] CAC (MPI) 1 -37
[225] T: 1472, 9-1473, 9

levels as you're getting in into projects. So that's one (1) area. And then the other area is -- and if you think back, this -- a year ago would be to actually implement and apply discipline to the gating process that -- that I talked about which was an emerging discipline, an emerging concept. And this was to really actually to apply those, have rigour and have discipline about that ***...So my understanding is that it has been -- over the past year it has been put in place, and that there are a number of projects that have actually gone through that gating process.***

[Emphasis added]

324 He characterized the "gating" approach as a best practice[226]:

So using a value management process like that would be, you know, considered to be a best practice that the way that MPI has defined it, it kind of really talks through, you know, what those gates are. As described earlier, that's kind of -- those decision gating processes would be considered to be a best practice.

9.2.4 Appropriate Oversight and Reporting

325 Projects are managed to schedule through the review of Status Reporting and Project Delivery Controls. Project Delivery Controls provide a means to check that specific criteria have been met at periodic phases during a project's lifecycle.

- BTO manages projects to budget through the monthly preparation of a number of internal financial reports, which measure project cost to budget and forecast costs to the end of the project by year.[227]
- The monthly forecasts are prepared through interviews with project managers in which all remaining work is estimated and costs are assigned based on estimated resource usage in addition to any and all costs associated with the project. All time charged to projects is reviewed and validated by project managers to ensure that they are correct.[228]

[226] T: 1477, 5-11
[227] CAC (MPI) 1-37
[228] CAC (MPI) 1-37

- These financial reports are then reviewed by BTO management to confirm that the portfolio is tracking to budget. If issues are identified during this review, corrective action is taken.[229]
- Next, the project financials are reviewed by the BTO Steering Committee which is comprised of members of BTO Management and MPI Executive Sponsors. Any identified issues surrounding project variances and any identified corrective actions are discussed and the forecasts to completion are validated.[230]
- Finally, members of BTO and Finance management teams meet collectively with their Executives to review the project financials as stated in the Capital Master Summary. Additional meetings are held with project teams to review their respective project financials as required to ensure accountability and performance to budgets.[231]

326 On a quarterly basis, the Board of Directors is presented a status update on all strategic initiatives. At that time, any variance or risk to budgets or timelines are brought forward as well as the planned corrective actions.[232]

9.2.5 Project Prioritization

327 Proposed project investments are reviewed annually by the MPI Executive. MPI Executive selects initiatives which address corporate needs, mitigate corporate risks, and advance corporate goals.

328 The selection process includes the following evaluation considerations:

1. Required Changes are first priority and must be completed by mandated timelines. (These are often legislated changes; an example would be annual process and technology updates required to enact changes from an approved Rate Application.)

[229] CAC (MPI) 1-37
[230] CAC (MPI) 1-37
[231] CAC (MPI) 1-37
[232] CAC (MPI) 1-37

2. Strategic projects are reviewed next with focus on alignment to corporate strategic goals, external events (ex. changes in repair technology impacting Manitoba trades), and societal changes (ex. autonomous vehicles). Based on these conditions, programs are enacted, revised, deferred, and completed.
3. Technical projects are reviewed next with focus on the capabilities required for current / future strategic goals and risk mitigation, ensuring that technical requirements are addressed. Emphasis is placed on ensuring platforms remain on current and supported versions. Technical projects are compared by cost, risk (current / potential impact to the business of not making the change), and capability (required as an enabler for strategic projects).

329 This approach provides a consistent frame of reference for allocating a finite IT budget.

9.3 Gartner's IT Assessment is Favourable

330 MPI engages Gartner Consulting, a leading information technology research and advisory company to conduct IT benchmarking on an annual basis. The fact that MPI retains Gartner year after year, demonstrates the Corporation's commitment to improving IT infrastructure and operations, while increasing accountability and reducing costs. Gartner's reporting shows that MPI has made significant progress and is now well positioned when it comes to IT.

9.3.1 Gartner IT Benchmarking and CIO Scorecard

331 The evaluation instruments that Gartner uses, and the objectives of that review, are as follows[233]:

[233] MPI Exhibit 45: slide 2 (PDF page 3)

Three structured evaluation instruments	Provide the following outcomes
▪ IT Spend Analysis ▪ CIO Scorecard ▪ Infrastructure & Operations Scorecard	▪ Evaluate the relative maturity of the IT organization ▪ Assess the IT organization's ability to react to rapidly changing business requirements ▪ Compare relative funding levels of IT at MPI ▪ Compare MPI's infrastructure and operations costs, staffing and service levels with those of similar enterprises

332 Gartner's methodology is described further in the Application.[234] It is important to note that the timing of the Benchmarking exercise does not allow the CIO scorecard to be filed with the Board in the same year it is completed. The CIO scorecard available to the Board in a given year only reflects progress up to the previous year.

333 Gartner's annual scorecard (included in *Volume III AI.12 Benchmarking Appendices Appendix 5*) includes several of the metrics referenced in *CAC Round 2 Questions Appendix B*), with comparisons to a peer average:

- *IT Process Maturity*
- *IT Spend as a % of Revenue*
- *IT spend per employee*
- *IT spend allocations (Run/Grow/Transform)*
- *IT spend as a % of operating expenses*
- *IT Budget Cost Distribution*
- *IT Infrastructure and Operations Cost Distribution*
- *IT FTE as a % of Company FTE*
- *IT FTE Cost Comparisons*

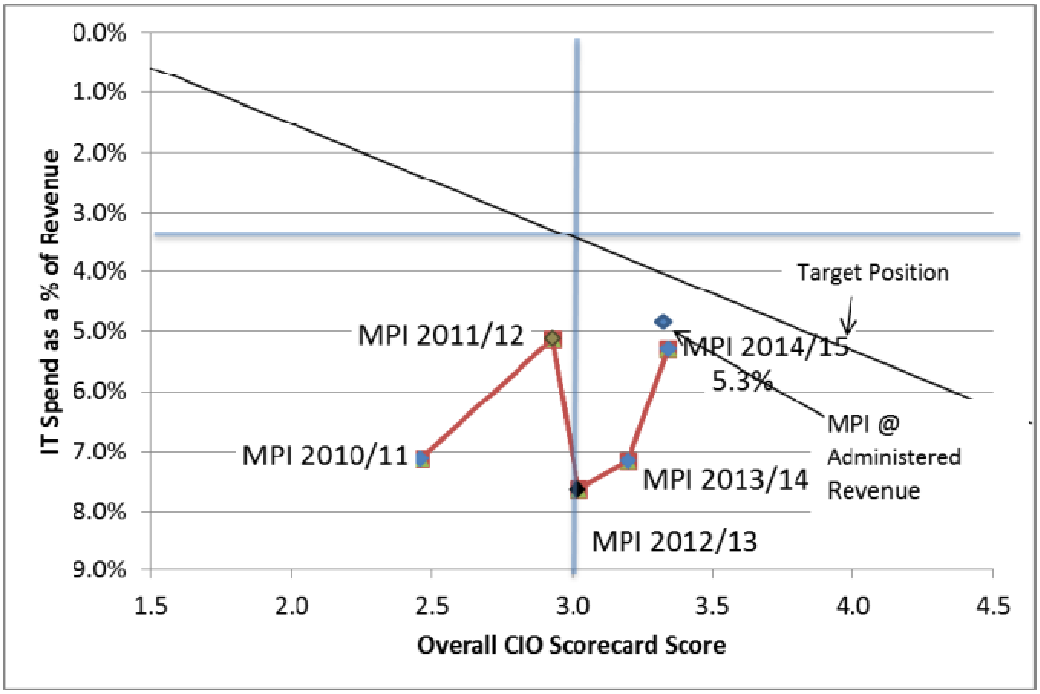
334 Additional operational measures, referenced in *CAC Appendix B*, that are tracked operationally include:

[234] MPI Exhibit 1: Volume 1, Benchmarking, BMK.7.2, page 37

- *Unit costs for IT Infrastructure*
- *Delivery vs. SLA (Managed Services)*
- *Availability (quarterly)*
- *Defects*
- *Incidents (including Security)*
- *Changes*
- *Response time (varies by technology)*
- *User satisfaction (annual)*

9.3.2 Overall Results

335 The overall results are depicted in the following figure included in Mr. Geffen's opening presentation[235]:



336 The red line on this figure tracks MPI's progression over the past several years in terms of its IT investment (vertical, with the top being most desirable) and overall

[235] MPI Exhibit 45: slide 3 (PDF page 4)

maturity (horizontal, with the right being most mature). The figure tells an important story:

- The position in 2011/2012 reflects underinvestment in IT;
- That underinvestment was followed by an inevitable spike in investment in 2012/2013 as MPI sought to catch-up;
- The level of investment, as measured by IT spending as a percentage of revenue, is now moderating, as MPI has regained ground. It is now at the target level of investment, and sustained investment at this level will move it towards the target maturity.

337 The figure illustrates that MPI's IT spending has now reached a steady state, and is not expected to increase again based on the project plans and methodology in place. When one considers administered revenue, instead of revenue generally, MPI's performance improves even further; this is reflected in notation "MPI @ administered revenue".

9.3.3 Notable Individual Metrics

338 The Corporation compares well against the benchmark groups in many of the IT metrics. Below are selected key 2014/15 benchmark indicators that demonstrate that the Corporation continues to improve on important IT metrics related to expenses, staffing and maturity. For the full listing of efficiency measures please see *Volume III AI.12 Benchmarking Appendices Appendix 2*.

339 Gartner identified that MPI's maturity in IT Cost Containment exceeded peer groups and has shown steady improvement since 2011/12.[236] The overall IT maturity score increased by 4.4% from last year to this year. This is depicted below[237]:

[236] CAC (MPI) 2-22
[237] MPI Exhibit 1:Volume 1, Benchmarking, BMK.7.2, page 41

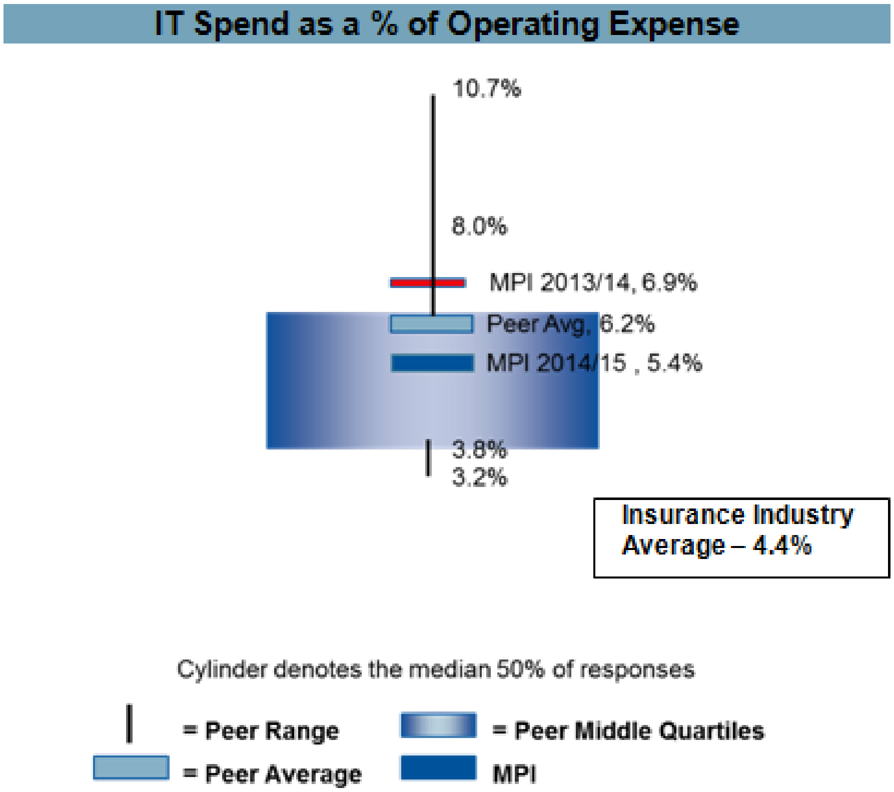
	MPI 2012/13	MPI 2013/14	MPI 2014/15	Team Player 2014/15	Insurance Industry 2014/15
Overall Score	3.02	3.20	3.34	3.03	2.82

340 There are eight different IT process areas reviewed for maturity. In seven of those eight areas, MPI is as good as or better than its peers at a defined or a managed level.[238] In the one area where it is relatively low (which happens to be the only maturity score mentioned by CAC in its Closing Submission), the industry is itself relatively low and MPI is not far off.[239] Hence, the overall score on maturity is approaching the "target" that Gartner has identified for MPI.

341 Another significant improvement is that MPI's IT spending as a percentage of operating expense is currently lower than MPI's peers. The following chart illustrates the point.[240]

[238] T: 1445, 22-1446, 5
[239] T: 1446, 6-12
[240] MPI Exhibit 1: Volume III, AI.12 Benchmarking Appendices, Appendix 6, page 61

Evaluation: Compare MPI's IT staffing to comparable organizations in the same industry:



342 The IT FTE as a percentage of Company Employees ratio continues to improve from 18.4% in 2012/13, to 17.2% in 2013/14. In 2014/15 it has decreased to 16.6%. Gartner measures IT FTE as including both internal and external FTEs.

343 MPI recognizes, as Gartner noted, that the Corporation tends to use IT consultants more than its peers. In regards to MPI moving IT consultant positions from outside the organization to creating internal IT positions, Mr. Geffen stated[241]:

> *We understand that MPI—it has been working on looking at this specific issues and we know of a number of instances where MPI has brought individuals on the staff and they've taken roles and moved then from a contracted person to a staff person, so yes, there has been a lot of movement there.*

[241] T: 1464, 13-21

344 Mr. Geffen observed that there are reasons why companies like MPI may choose to hire IT consultants vs. hiring full-time employees[242]:

- Skilled IT resources are very difficult to acquire in a marketplace (there is a lack of availability of uniquely skilled IT resources), so the way to acquire those skills and experience are through external contracting[243]
- Organizations are often looking for flexibility to be able to ramp up skills and experience to address needs of a specific project, or on a term basis[244]
- Based on compensation structures, some organizations cannot attract resources to do the specific kinds of roles and responsibilities. The solution is to go out and contract those types of resources when they are needed on staff.

345 As noted by Gartner in the scorecard, a certain number of highly skilled IT consultants will likely continue to be required in the future: "MPI will still require a highly skilled and professional staff in-house to oversee the third party and support the architecture, long-range planning, etc. for the benefit of Manitobans."[245]

9.4 Walking the Walk on IT Management

346 CAC characterizes MPI's Information Technology management as not 'walking the walk', and suggest that Mr. Guimond's evidence on value management was contradicted by other evidence.[246]

347 First, a complete quotation of Mr. Guimond offers context around the statement "we've always done value management"[247] that was paraphrased by CAC:

MR. BYRON WILLIAMS: And it's described by the Corporation as a new process, and the process measures are being applied to new projects this fiscal year, agreed?

[242] T: 1466
[243] T: 1466
[244] T: 1466
[245] MPI Exhibit 1: Volume III, AI.12 Benchmarking Appendices, Appendix 6, page 61
[246] CAC Exhibit 27: Slides 72 -74
[247] T: 789, 3-12

MR. DAN GUIMOND: Agree in terms of -- of how -- how we do value management at this point in time, but we've always done value management. Whether it was done before by internal audit, or whether it was done by other areas of the Corporation, we've always done it, but this is how we do it now.

348 Mr. Guimond is supported by evidence on the record. CAC's incomplete paraphrasing is setting up a false "straw dog".

349 Second, CAC is conspicuously silent on Gartner's nore favourable conclusions, which provide an objective assessment that MPI is "walking the walk". When the CAC suggests that we would all 'like new laptops'[248], it does so ignoring the fact that Gartner specifically identified the Cost Containment measure in its CIO scorecard as having significantly improved since 2011, and currently exceeds peer groups. Further, CAC made no effort in cross examination to understand the age the assets to be replaced, or without seeking to understand operational requirements.

350 The CAC identifies only one maturity measure in the CIO scorecard[249] that remains low, ignoring two important facts. First, the Business Process Management metric is the most improved, and second, MPI exceeds benchmarks in 5 of the 6 remaining maturity categories, as well as the Overall Score.

9.5 BI3 Initiative

351 Injury claims take several years to develop, and the BI3 business case stated that it will take at least seven years for the initiative to be fully functioning and achieving desired outcomes. The Corporation has indicated that it will report on the BI3 initiative when it is appropriate to do so.

352 The record of this proceeding has not been sufficiently developed for the Board to make findings with respect to BI3, and the Corporation anticipates providing a report on BI3 for the PUB's consideration in the 2018 GRA.

[248] T: 2226,9 -10
[249] CAC Exhibit 27: slide 64

9.6 CAC's Proposed Rate Indication Should Be Disregarded

353 The CAC proffered its own 3% rate increase based on the AAP rate indication of 4.8%, and subsequently reduced by 1% for investments and 0.8% to 'send a signal' to MPI on IT and investments.

354 MPI notes two fundamental flaws in the CAC's proposal. First, sending a 'signal', or a 'message' is not a recognized rate making principle, on which to award or deny a rate request. Second, the CAC's proposal is not supported in any way by the evidentiary record. CAC proffered no quantitative evidence in support of the reduction from AAP rates, and relied simply on 'eyeballing'[250] the result. The evidence on IT costs underscores the fundamental unfairness in CAC's approach. The evidence is that budgeted IT expenditures have a negligible effect on the rate indication.

355 The CAC's proposed rate indication is fundamentally flawed, and should be disregarded in its entirety.

[250] T: 1607, 17 -21

10.0 Physical Damage Re-engineering

356 This Section addresses the evidence on PDR. In response to PUB Order 128/15, MPI retained Gartner to prepare an evaluation of the PDR program. Mr. Geffen, Vice President of Gartner Consulting was responsible for the report. He provided a fair and even-handed evaluation. While he identified some issues with MPI's past work on PDR, Mr. Geffen was clear that (i) the PDR program is on track, (ii) MPI's governance process for PDR is in place, (iii) that benefits are being realized, and (iv) that risks are being mitigated.

357 MPI focuses on the following points in this section:

a. First, PDR is the right foundation for the "new normal";

b. Second, PDR is on track and on budget;

c. Third, MPI has adopted Gartner's governance recommendations;

d. Fourth, costs and benefits of PDR are defined and achievable;

e. Fifth, Mr. Geffen and MPI provided compelling answers to specific issues raised about PDR during the proceeding.

10.1 PDR is MPI's Foundation for Operating in the New Normal

358 Auto manufacturers are adopting new complex materials, in addition to onboard technologies, that are increasing the cost to repair vehicles. These changes in the automotive industry will impact MPI and the repair industry. PDR is a cornerstone in MPI's strategy to adapt to the new normal. Mr. Guimond explained that PDR will ensure that Manitobans are able to "have their highly sophisticated vehicles repaired in a safe, trusted manner".[251] MPI will lead industry repair shop

[251] T: 153, 11-13

accreditation and adherence, which will continue to grow in importance as we move through the stages of autonomous vehicles and manage the increased use of new complex materials.

359 Gartner's program evaluation notes[252]:

> *The PDR Program is aligned with what Gartner is observing and projecting for the Property and Casualty Insurance Industry…*
>
> *There is little dispute that digital insurance holds the promise to foster innovation and literally transform the industry by enabling new products, services and delivery channels that can generate new revenue, add value across the entire insurance value chain, and improve customer acquisition and retention.*

10.2 PDR Program is on Track and on Budget

360 The PDR program budget has been consistently maintained at $65 million (in 2012 $CAD). Gartner observes that progress has been steady, if slow, due to changes in direction regarding the definition of projects that comprise PDR[253]. Gartner's review of the Program Charter and project plans had lead it to conclude that the in-progress projects are reasonable and achievable.[254]

361 Both MPI and Mr. Geffen were asked about a prior change in direction. MPI's evidence was that this was a deliberate decision.[255]

362 Gartner's evaluation confirmed that changes of this nature are to be expected in a program with the complexity and duration of PDR.[256] Deliberate changes are also

[252] MPI Exhibit 1: Volume I, PDR Attachment A, PDF page 3-4
[253] MPI Exhibit 1: Volume I, PDR Attachment A, PDF, page 4
[254] MPI Exhibit 1:Volume I, PDR Attachment A, PDF, page 4
[255] T: 631, 10-25
[256] MPI Exhibit 1: Volume I, PDR Attachment A, PDF, page 4

desirable to ensure that the project achieves the intended outcomes for MPI, its customers, and the industry. Mr. Geffen explained[257]:

> *MR. MARTIN GEFFEN: It -- we do recognize that the program did under -- did undergo scoping, and refinement, and planning, re-planning of -- of the various projects.* ***The projects have been mapped to the outcomes to identify what the business outcome should be and what -- what the quantitative benefits should be.***
>
> *And the -- what we -- what we find is that in programs as large and complex as this, it's not unexpected that you would have course correction. You'd -- you'd have some changes. What we look for in our ready -- risk and readiness assessment practice is that these are purposeful and conscious changes, that organizations are making them, as I say, consciously and purposefully, that they document the changes and that they actually identify the impact both to costs and to expected benefits.*
>
> *We often see in large programs like this that -- that will continue, you know, for a number of years that you'll get to a certain place and you'll -- the organizations will not be where they thought they were going to be at the very beginning. And if -- and so we -- we look for organizations to have some structure around doing that kind of mapping and -- and doing course corrections.*
>
> *And so we --* ***since we understand that that kind of scoping refinement and the mapping of outcomes is to be expected, what the benefits are that -- that we look for are that we actually do a real – that -- that the organizations do a rea -- rea -- realignment of scope, that they understand what the costs are of the changes, what the -- the timing is -- changes will be and what the benefits are -- are likely to be from those -- those course corrections. And that they are using that analysis to really identify and mitigate the potential for additional cost, extended timelines, or deferred benefits realization.***
>
> [Emphasis added]

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[257] T: 1449, 23-1451, 9

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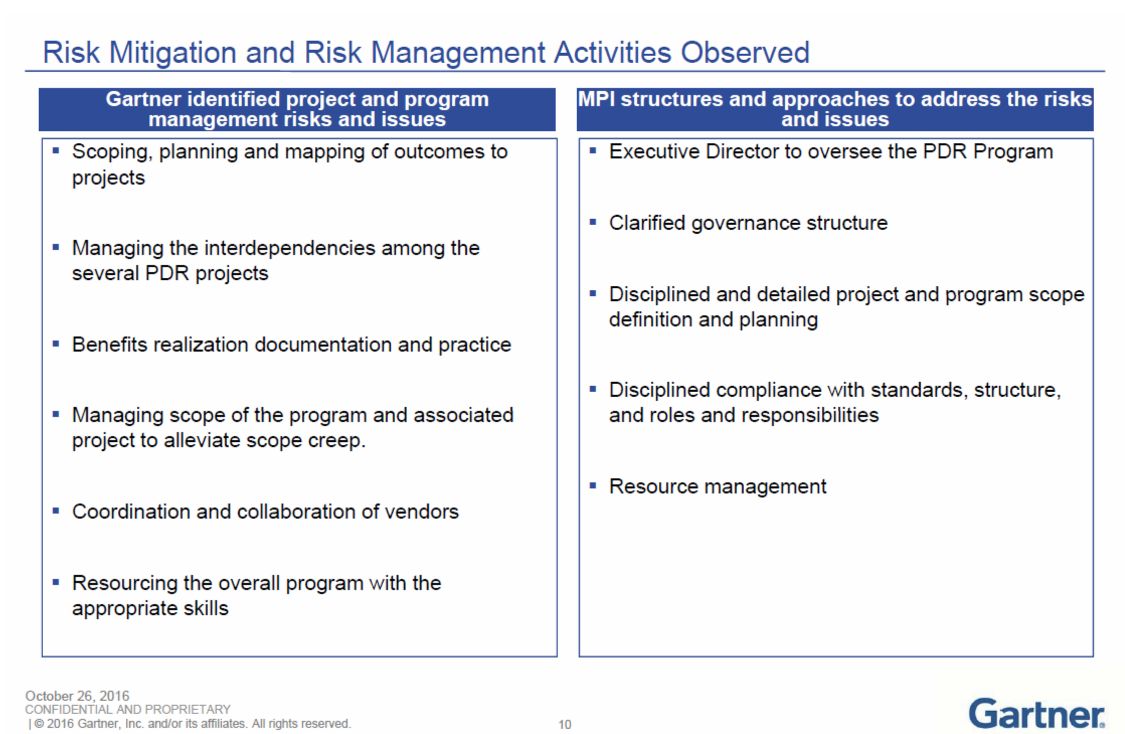
363 MPI manages the program dynamically, and continuously monitors initiatives to ensure business objectives are achieved within the budget[258]. MPI's course corrections through the PDR program demonstrate its careful consideration, reflection on experience gained through earlier stages of the project, and careful management of the PDR program.

10.2.1 MPI Has Adopted Gartner's Governance Recommendations

364 Gartner's evaluation identified some areas for project governance improvement, and MPI has addressed them. MPI has provided details of its enhancements to program management, which were itemized by Mr. Geffen, at Volume I PDR Attachment C pages 2 and 3. Mr. Geffen provided the following slide in his opening statement which summarizes the Corporation's actions that address the risks identified in the evaluation.[259]



[258] MPI Exhibit 1:Volume I, PDR Attachment C, page 1
[259] MPI Exhibit 45: slide 10 (PDF page 11)

365 Mr. Geffen explained how the steps MPI had taken had resulted in a much clearer governance structure, and improved discipline and diligence in scope definition and planning[260]:

MR. MARTIN GEFFEN: The -- MPI has reported putting a number of structures and approaches in place to address those risks. And the -- the five (5) salient ones that are worth -- I just wanted to – to highlight over here is putting an executive director in to oversee the PDR program, which drove them to a much clearer governance structure in terms of how we actually make changes, what we expect from – from each of the -- the projects themselves, what roles and responsibilities are, how we'll actually invest in -- in the various projects.

A greater degree of discipline and diligence to doing pro -- project and program scope definition and planning. Discipline and diligence, it requires -- to compliance around standards, structure, roles and responsibilities for all of the operations, and then an overall resource -- leveling resource management, okay.

366 Mr. Geffen confirmed that the task is now to maintain the discipline currently in place[261]:

MS. KATHLEEN MCCANDLESS: Now, with respect to the -- the issues influencing this – the progress and -- and the slow progress, are there any strategies that you would propose to ensure that the project is delivered on a cost effective basis?

*MR. MARTIN GEFFEN: So, sure – so looking forward, **I think that there actually is a pretty clear structure in place right now**. So having gone through a -- kind of the revisioning process that took place a while ago, I can't -- the -- and the restructuring of the -- of the -- the projects in place, I think that we actually -- going forward I think we actually have a -- a -- **there is a well defined project portfolio**.*

[260] T: 1453, 20-1454, 12
[261] T: 1497, 17-1498, 12

So in terms of strategy going forward I think that it's, you know, have discipline and – and -- to that project portfolio foc -- focus on -- on, you know, maintain that project portfolio, maintain the scope, and -- and scale of -- of each of those projects and have discipline and diligence to -- to that -- to that roadmap.

[Emphasis added]

367 There is every reason to expect that MPI will maintain and build on the governance process improvements already undertaken.

10.2.2 Costs and Benefits are Defined and Achievable

368 The PDR program is expected to generate steady benefits commencing in year 7, and will achieve $13.65 million in annual savings by year 11 (2020/21).

369 The first benefits have been realized from the project in 2016/17, and net annual benefits are projected to turn positive in 2019/20[262]. The program financials deliver an internal Rate of Return of 8%, and an NPV of $18 million, at a 3% discount rate. PDR would still have a positive NPV of $5 million[263], under a doubling of the discount rate to 6%. Any positive NPV, no matter how small, indicates that from a financial perspective, undertaking this project is preferred to the status quo.

370 Gartner has validated PDR's costs and benefits in its program evaluation.[264] Mr. Geffen noted that the benefits of the PDR program have already begun[265]:

MR. MARTIN GEFFEN: Benefits are -- are -- will – while they take a long time to realize they seem to have started early, and the -- there is a mapping between the projects and the benefits so that there's a reasonable expectation that you will achieve those benefits in the timelines projected.

371 Mr. Geffen also noted the presence of appropriate back end auditing and validation to provide checks and balances[266]:

[262]MPI Exhibit 1: Volume I, PDR Attachment A, PDF page 26
[263] PUB(MPI) 1-61: PDF page 2
[264] MPI Exhibit 1: Volume I, PDR Attachment A, PDF page 4
[265] T: 1456, 2-7

MR. MARTIN GEFFEN: And, you know, a number of the twenty (20) projects within PDR are systems, and solutions, and instructors in place to do audit and -- and back- end auditing, and validation, and certification, and administration. So there's that kind of check and balance there as well, yeah.

372 Further, MPI is taking steps to ensure that the benefits from PDR will be measured through the value management process, which Mr. Geffen favours[267]:

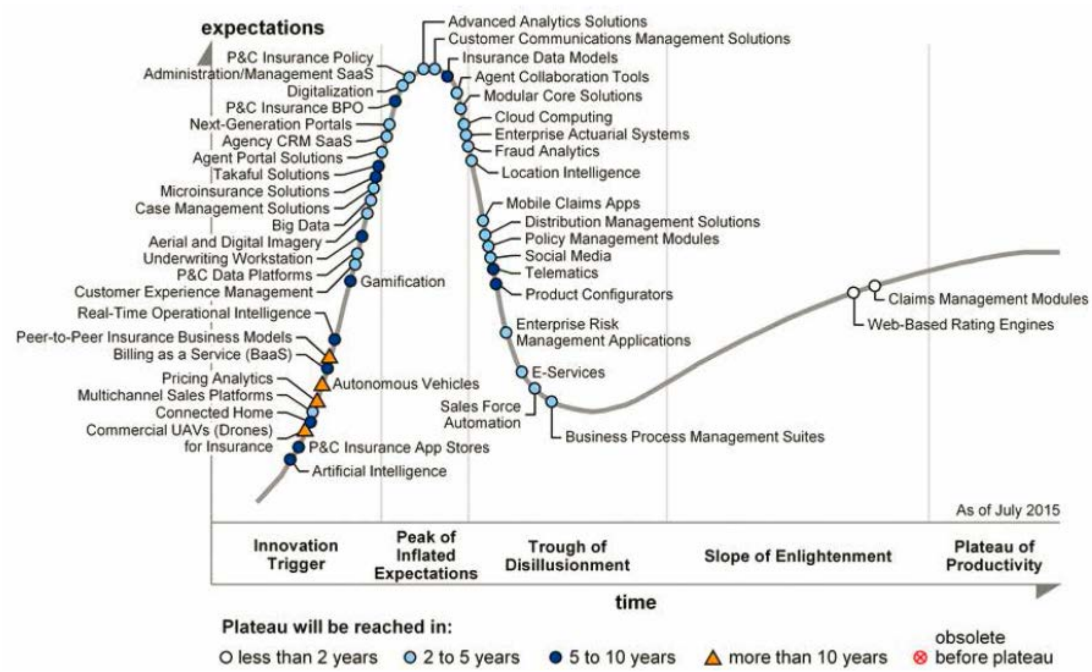
MR. MARTIN GEFFEN: Our understanding is that new projects will be going through the -- the upfront gating pro -- gating process and, of course, will have the back-end benefits realization process and that MPI is working to apply the back-end process, the -- the benefits realization process analysis to -- to PDR

10.3 Answers to Specific PDR Issues Raised

10.3.1 The Hype Cycle

373 In cross examination, counsel for the CAC focused on two PDR elements reflected on Gartner's "hype cycle"[268], Advanced Analytics and Mobile Claims Apps. The "hype cycle" identifies Advanced Analytics at the peak of the 'inflated expectations' and Mobile Claims Apps descending into the 'trough of disillusionment'. CAC raised this again in Closing Submissions.

[266] T: 1558, 25-1559, 5
[267] T: 1539, 7-12
[268] MPI Exhibit 1: Volume I, PDR Attachment A, PDF page 10



374 Gartner's Hype Cycle measures just that – 'Hype'. It is a model for classifying and tracking expectations for emerging technologies, and not a model for measuring realizable value.

375 As indicated by Mr. Geffen, the appropriate action to take with these projects is to "stay the course"[269]:

MR. MARTIN GEFFEN: Right. So right now, mobile claim apps, again, are kind of -- they're no -- no longer seen as kind of the silver bullet, the next great thing. People are kind of saying that, you know, it's good. It's -- it's -- you know, people are having concerns about adoption.

You'll -- the -- but it will then – it will move through that process where people will be quite negative. Some organizations might be quite negative about it. Is it actually delivering -- the -- the kinds of questions that you get is, you know, did we do the wrong thing, did we waste our money?

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[269] T: 1555, 19-1556, 13

And, ***frankly, our advice based on this model is, in general, you need to actually push through that Trough of Disillusionment because you will get -- you will get value out of it****, but you kind of need to push through -- through that period where you actually -- kind of the dark days in -- in a technology where it's kind of not delivering what you expected it to deli -- deliver.*

[Emphasis added]

10.3.2 First Notice of Loss (FNOL) and Mitchell

376 CAC questioned MPI witnesses and Mr. Geffen about the FNOL program and Mitchell's role with it. The evidence of MPI and Mr. Geffen was that the FNOL project promises significant benefits, and the risks associated with it were being addressed.

377 The FNOL project is a key part of the PDR program. It will provide key information about the claim, and develop an accident profile.[270] Mr. Geffen expressed the potential that FNOL presents as follows:

MR. MARTIN GEFFEN: the FNOL app is intended to compute a profile for that incident, and then be able to initi – initiate the adjudication process based on that profile which is driver-based, vehicle-based, and -- and incident based.

And so all of those things are relatively new in the industry. That's -- that's kind of what's new here, and if -- if I were to be bullish on this, I would say that -- that would actually then drive efficacy and efficiency and it would drive -- it would -- it would create enhanced user experience, because I can actually get the data in, start the adjudication process, have the insurer and the repairer or organization actually start working on -- on adjudicating the -- the claim based on what I've done at roadside.

378 Gartner's evaluation identified as a risk, Mitchell's commitment to and ability to deliver commercial software that delivers the needed functionality for the FNOL

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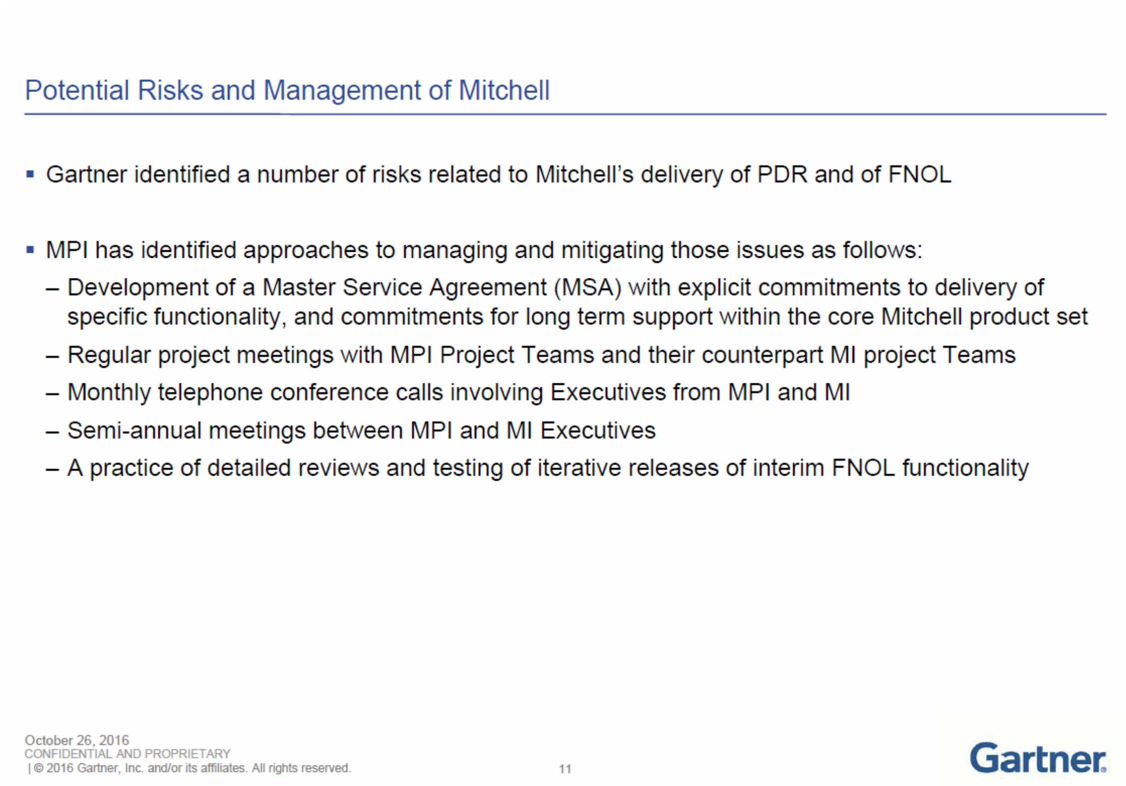
[270] T: 1549, 15-1550, 5

project. The risk is not about Mitchell's quality. MPI has a long and successful track record working with Mitchell. The risk arises because MPI is partnering with Mitchell to provide an innovative offering, and one that will need to be supported going forwards. Mitchell has shown every indication of working with MPI to make FNOL a success.

379 Mr. Geffen presented his conclusion that the Corporation has identified approaches to mitigating these risks, which were itemized in his opening remarks[271]:



380 Mr. Geffen further explained[272]:

MR. MARTIN GEFFEN: We identified a number of risks spe -- specifically with the potential to Mitchell, and those really fall into two (2) -- two (2) key areas. 1) Will -- the expectation is that for FNOL and for the 17 distributed estimating,

[271] MPI Exhibit 45: slide 11
[272] T: 1454, 13-1455, 13

the -- MPI is really – is looking to acquire a product, an ongoing commercial project much like the product that they have acquired through FINEOS and through the existing products and services that they acquire through Mitchell.

And so one (1) of the risk was Mitchell's level of commitment and ability to build all the new functionality and maintain it within a commercially available product.

And the second issue was around Mitchell -- Mitchell's ability to actually develop the functionality that was required for -- that MPI requires to -- to achieve its business outcomes.

And MPI has identified a number of approaches to -- to mit -- mitigate and manage those. And those -- those are documented over here, developing of a master service agreements to document the actual commitment to -- to deliver both functionality and on a -- on a commercially viable ongoing basis, and then on -- an ongoing review cycle through meetings at all levels of the -- of the organizations.

[Emphasis added]

10.3.3 Pilot Projects

381 MPI has provided the PUB with extensive information on the Distributed Estimating (DE) Pilot Project at the May 26th, 2016 in-camera session. Those materials remain available to the Board and interveners.

382 Gartner’s program evaluation reviewed the status of the pilot projects and concluded that they have achieved projected outcomes:

MR. MARTIN GEFFEN: There are three (3) pilots that have been performed, and -- and two (2) of them have been completed -- estimating and auto checks. The distributed estimating pilot is still in progress, and there are two (2) other pilot projects I believe, and I'd have to go back to my notes to confirm that number, that are in progress or in plan or being planned.

From what we've seen with the completed pilot projects, they achieved the -- the outcomes that were projected for them and -- to move forward. And *distributed estimating, the one that's in pro -- progress is delivering the insights and benefits that -- that are expected.*

10.4 Risks to PDR are Known and Manageable

383 In its closing argument, the CAC argued that there are significant risks to PDR program related to i) the Hype cycle, and ii) effective oversight.

384 MPI addresses CAC's concerns with the Hype cycle above, and would further note that effective oversight is a known risk, which is being addressed. The following exchange is informative[273]:

MR. BYRON WILLIAMS: And the concern from the Corporation's perspective there, sir, being that while there are opportunities with distributed estimating there are also risks in the sense that the corpor -- the firms undertaking the distributed estimating might have some incentive to puff up their estimates.

MR. DAN GUIMOND: Yes, the – the distributed estimating program -- we've looked closely at what ICBC has been doing for many years but you're quite right that you need to put processes in place through key performance index, earn authority in terms of how much they can approve on their own, having people on site, quality control programs, quality assurance programs have to be in place, and you have to have really -- you have to -- you have to really assure yourself that -- that the processes that you have in place, and you have to have really -- you have to -- you have to really assure yourself that – that the processes that you have in place can mitigate potential leakage, yes.

385 MPI is well aware of the risks, and is actively addressing them through the PDR program, with the 'checks and balances'[274] that are incorporated into the program.

386 MPI will continue to be diligent in its management and oversight of the PDR program, and will file with the Board, an updated evaluation with the 2018 GRA. At

[273] T: 819, 13-820, 8
[274] T:1559, 2-5

this stage is it anticipated that such a follow up review would be completed by Gartner.

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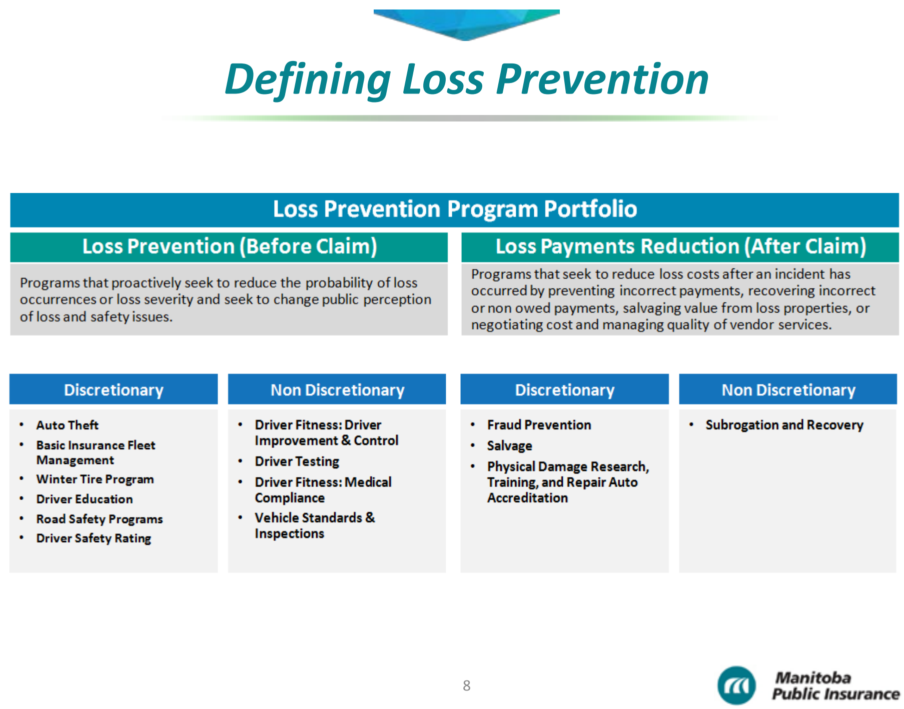
11.0 Loss Prevention

387 MPI has, for many years, invested heavily in road safety and loss prevention. MPI expects to invest $13.2 million in 2017/18 and $14.1 million in 2018/19, reflecting MPI's ongoing commitment to improving safety and reducing loss costs.[275] MPI's Road Safety and Loss Prevention framework and initiatives are described in detail in the Application, Volume I, "Loss Prevention".

388 MPI's loss prevention portfolio is summarized in slide 8 of Mr. Keith's presentation[276]:



389 In this section, MPI addresses specific issues raised in the proceeding and makes the following points:

[275] MPI Exhibit 1: Volume I, OV.11, page 38
[276] MPI Exhibit 42: slide 8

1. MPI has an appropriate framework in place for identifying initiatives, setting priorities, implementation and oversight.
2. MPI reflects claims costs and human toll, with broader social costs addressed on a provincial basis.
3. MPI's bottom-up approach to establishing its road safety budget is appropriate, as it allows for funding of beneficial programs.
4. MPI's road safety portfolio includes appropriate initiatives directed at vulnerable road users, including cyclists.
5. MPI has adopted an appropriate approach to managing risk of wildlife collisions that makes the most efficient and beneficial use of policyholder resources.
6. MPI continues to invest in motorcycle safety and this investment augments the programming that applies to all vehicles.

11.1 Appropriate Loss Prevention Framework

390 MPI's Loss Prevention Strategy and Framework ("Framework") is a formalized framework that allows the Corporation to identify initiatives, set priorities, and implement, oversee and evaluate programs. The evidence demonstrates that the Framework is consistent with best practices.

11.1.1 Value Management, Engagement and Evaluation

391 The Framework incorporates prevention programs, legislated vehicle and driver standards and post-collision cost containment. This holistic approach is grounded in research and analysis with a focus on evidence based, proven strategies that allow MPI to address a problem on several fronts or over a long period of time. This approach also enables collective tracking and establishes benchmarking used to assess the efficacy of the Corporations overall program expenditures.[277]

[277] MPI Exhibit 1: Volume I, LP.2, page 10

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392 MPI uses a value management process to determine the efficacy of various programming, summarized in the following slide[278]:

393 As part of the value management process, MPI has developed more robust business cases. The business cases employ indicators to ensure that the funds are being spent appropriately and include appropriate outcome measures. Mr. Keith spoke about the difficulty of determining a direct return on investment for road safety initiatives[279]:

> *And I think what we will find is that when it comes to road safety initiatives of this nature, it -- it is very, very difficult to be able to develop a return on investment methodology that specifically correlates expenditures of this nature with subsequent reductions in collisions, claims, and claims costs where impaired driving or distracted driving, or what have you, is determined to be a contributing factor. It's a piece of the puzzle but -- but based on the -- the nature of road safety very difficult to dissect that puzzle.*

[278] MPI Exhibit 42: slide 9
[279] T: 1125, 9-20 see also T:1100, 3-24

394 In Closing Submissions, CAC held out Loss Prevention business cases as a model.

395 Stakeholder engagement is an important part of the process. Mr. Keith explained that the Corporation seeks input through a variety of channels including: (i) MPI's External Stakeholder Committee on Loss Prevention, (ii) The Provincial Road Safety Committee, and (iii) Industry and Stakeholder Collaborations including collaborations with Bike Winnipeg, CMMG and CAA Manitoba.[280]

396 Mr. Keith stated[281]:

> *We recognize that stakeholders can and must have a say in our road safety and loss prevention efforts. Their contributions will be welcomed, and they will influ -- influence our decisions.*
>
> *Specifically there are three engagement forums that we have addressed in our submission for this year. The first is the external stakeholder committee on loss prevention. The terms of reference for that committee, as well as minutes to those -- those collaboration meetings, have been shared. And those have been shared in PUB-1-52 and 1-53 in the first round Information Requests.*
>
> *We are also continuing to participate on the Provincial road safety committee. Terms of reference for that committee have now been finalized. MPI is co-chairing that committee, along with Manitoba Infrastructure. And the terms of reference and committee outcomes to-date for that committee have also been shared in PUB-1-54 and 1-55 of the first round.*
>
> *I'm also pleased that outside of these formal stakeholder committee structures we have had a number of other opportunities to work directly with industry and stakeholders on specific issues of common interest.*
>
> *And just a brief listing, and not a complete listing, of the stakeholders that we've worked with over the last couple of years include the Manitoba Association of Chiefs of Police, the Manitoba Trucking Association, Bike Winnipeg, CAA (Manitoba), the Coalition of Manitoba Motorcycle Groups, Safety*

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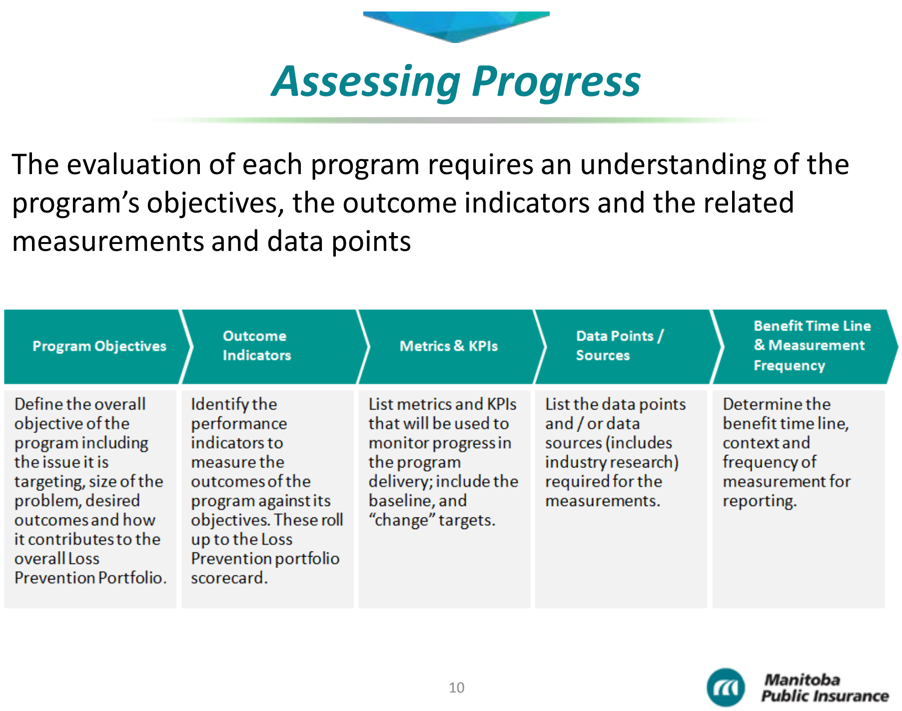
[280] MPI Exhibit 1: Volume I, LP.3.4, page 18-28
[281] T: 946, 3-947, 21

Services Manitoba, and IRCOM, which is the Immigrant and Refugee Community Organization of Manitoba which is the organization that we partnered with to deliver and provide adult driver education programming specifically to new immigrants and refugees to Manitoba.

Our intent, as I said and as recommended by this Board, is to move our stakeholder collaborations outside of this regulatory process. And know that when there are collaborations to be had and input to be shared, perspectives to be provided, that there are frameworks in place to allow that to happen.

397 MPI has an evaluation framework, summarized on the following slide[282]:



398 MPI is making progress towards the development of a scorecard that will inform decision making. Mr. Keith emphasized that this evaluation approach will be

[282] MPI Exhibit 42: slide 10

focused on the overall outcomes of the loss prevention portfolio in light of the practical obstacles to evaluating on an initiative by initiative basis[283]:

> *The purpose is to collectively be able to track and benchmark overall loss prevention expenditures and produce where possible, a loss prevention scorecard that demonstrates positive return on investment at the portfolio level.*
>
> *I say at the portfolio level, because as has been discussed in this hearing, and has been validated, I think you'll see from Ms. Kroeker-Hall's independent report, the nature of road safety programming is such that it is not always possible, in fact, it's sometimes impossible to draw a direct correlation between expenditures and road safety and resulting reductions in collisions, claims, and claims costs, because of the –- the nature of road safety, because of the many confounding variables that will be at play in terms of keeping our road safe, and because of the involvement and activities of other stakeholders beyond the Corporation's mandate.*
>
> *So the intent here, therefore, is to look at collectively all of the loss prevention programs that is – are administered at MPI and do a scorecard to create a return on investment calculation that determines that on an over holistic basis the funds that are invested in road safety programming are having an overall positive return on investment.*

399 MPI expects to have completed work on the scorecard in time for the next GRA filing.

11.1.2 Response to Interveners

400 The Corporation relies on the Framework and the recommendations of IBM to guide Loss Prevention efforts. Bike Winnipeg suggests that MPI has fallen short of optimization of the road safety budget, but does not acknowledge that MPI's road safety efforts are not governed by a cap, but instead by pursuing initiatives where a net benefit can be achieved. The process leads to optimization. Optimization is the result of the appropriate process, and not an amount determined in the abstract.

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[283] T: 939, 13- 940, 17

401 The CAC further suggests that MPI is playing catch-up to other crown insurers[284], in the area of cost benefit analysis in the loss prevention portfolio, but makes this claim without reference or acknowledgment of what MPI actually does, which is articulated above. CAC points to no specific deficiency in MPI's process but makes only vague allusions to MPI's inferior approach.

402 In fact SGI and ICBC have different mandates than MPI. MPI's mandate is limited within the provincial context, and cannot unilaterally impose targets. As a member of the Provincial Road Safety Committee, MPI can contribute towards defined road safety targets. The implications are clear: the Provincial Road Safety Committee must be allowed to carry out its work. The criticisms over targeted road fatality reductions leveled at MPI are misdirected, and premature.

11.1.3 Safe Systems, Target Outcomes and Vision Zero

403 There was significant discussion at the hearing about (i) the extent to which MPI applies a "safe systems" approach that looks beyond claims cost savings and (ii) whether MPI favors the use of targets for outcomes. MPI's evidence was that it does advocate these approaches at the jurisdictional level. Mr. Keith stated[285]:

> *Because you will see that with the terms of reference for the Provincial Road Safety Committee, consideration will be given to establish in quantitative targets where it makes sense to do so. And the Corporation will be supportive of that because it is at that table and in that environment that you have all of the players at the table who are going to be responsible for the achievement of those quantitative targets.*

404 MPI's approach makes intuitive sense, given that it is only one of a number of stakeholders with the ability to influence road safety.

405 Bike Winnipeg asked about a safe systems approach and vision zero. This line of inquiry seemed to miss the key point that these concepts are not mutually

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[284] CAC Exhibit 27: slides 122, 123
[285] T: 1104, 21-1105, 4

exclusive. To be clear, vision zero is an objective and safe systems is a framework that can be used to achieve the objective. Aspirational objectives are properly formed at the jurisdictional level, and the draft Terms of Reference[286] for the PRSC are clear that such matters will be considered.

11.1.4 Alignment With Best Practices

406 Ms. Kroeker-Hall conducted an independent review of MPI's road safety programming in 2015 to determine whether the programming is consistent with the Corporate Strategic Plan, current best practices, evidence based strategies and budget optimization.[287] She concluded, among other things, that the program was sophisticated and well-managed[288]:

> *Overall, MPI's road Safety model has evolved to a sophisticated and comprehensive level in terms of key elements required of a good road safety framework. From an holistic perspective, documentation of the processes and criteria for decision making, planning, research and monitoring, are underpinned by a data-driven and evidence–based approach and appears to exceed most Canadian jurisdictions. The current framework and its continuing enhancement will serve MPI well in re-shaping governance and program relationships including its participation in the new Provincial Road Safety Committee.*

407 MPI's Framework has evolved further since Ms. Kroeker-Hall performed her assessment. Recommendations from her evaluation have been incorporated into MPI's Framework as follows:

1 MPI has clarified its role in road safety leadership by co-chairing the Provincial Road Safety Committee with Manitoba Infrastructure

[286] PUB (MPI) 1-54: Attachment A
[287] MPI Exhibit 1: Volume I, LP.4.13, page 79
[288] MPI Exhibit 52: page 7

allowing MPI to lead in areas related to research, collision data and information and education.[289]

2 MPI has organized its loss prevention activities by forming the Loss Prevention Internal Working Committee and various working groups tasked with developing strategies for loss prevention related to particular vehicle classes such as commercial trucking and taxis.[290]

3 The Corporation requires complete business cases (including the expected economic or social return on investment) for all potential road safety programs.[291]

11.2 MPI Reflects Claims Costs and Human Toll; Province Reflects Social Costs

408 Bike Winnipeg inquired about why MPI does not use social costs in prioritizing expenditures. MPI submits that its current approach of focusing on claims costs and human toll is consistent with the Corporation's mandate. Social costs are addressed at the jurisdictional level.

409 In evaluating a road safety business case or the return on investment of particular road safety initiatives, MPI has historically used claims costs and human toll as appropriate evaluation measures.

410 Human toll will increase an issue's priority setting within the Corporation's framework.[292] As noted by Mr. Keith, the human toll factor has increased the priority of vulnerable road users[293]:

> *By leveraging human toll however, that is what has risen, bicycling safety and pedestrian safety in particular, indeed all vulnerable use – road users into a higher priority based on the methodology that we've developed to prioritize road safety issues.*

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[289] MPI Exhibit 1: Volume I, LP.5.1, page 82
[290] MPI Exhibit 1: Volume I, LP.5.1, page 82-83
[291] MPI Exhibit 1: Volume I, LP.5.1, page 83-84
[292] T: 1167, 2-5
[293] T: 1167, 17-22

411 Social costs are a very broad measure of costing. They include cost of the medical system, the cost of the employment system, the cost to family support systems, and so on. MPI has not used social costs as a measure of success given the many variables that fall outside of the Corporation's legislated mandate. However, MPI believes that social costing is relevant at the jurisdictional level.[294]

412 MPI is a Co-Chair of the Provincial Road Safety Committee which has the task of developing a Provincial Road Safety Plan. The terms of reference for this Committee include social costing. As noted by Mr. Keith[295]:

> *I would suggest that in – in that sort of a context when you're talking about a jurisdictional plan, kind of like targets, that is a more appropriate place to talk about social costing because you have all of the players at the table that can influence social costing, whether it be the cost of the medical system, the cost of the employment system, the cost to family support systems, what have you, well beyond the direct costs that are the responsibility of an insurance policy under contract.*

413 Since social costs impugn matters that extend beyond the legislated mandate of MPI, and indeed fall outside the mandate of any one agency or stakeholder, it is most appropriate to consider social costs at the jurisdictional level within The Provincial Road Safety Committee.

11.3 Beneficial Projects Get Funded

414 In PUB Order 128/15, MPI was ordered to advise the Board of what percentage of its revenue should be allocated to Road Safety and Loss Prevention initiatives and why. MPI submits that the appropriate amount of spending will vary, and is not conducive to being defined with reference to a percentage of revenue. MPI's bottom-up approach to establishing its road safety budget is appropriate, as it allows for funding of beneficial programs.

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[294] BW(MPI) 1-12: 1
[295] T: 1169, 16-25

415 MPI funds programs that align with Corporate priorities and are expected to provide a net economic and social benefit (to the extent that such benefits are quantifiable).[296] Instead of limiting Road Safety and Loss Prevention program funding by either targeting a percentage of revenue or capping funding, MPI is able to pursue demonstrably valuable programming and provide the funds that the program requires rather than being bound by an arbitrary funding target.[297]

416 As noted in section 11.2 and confirmed by Mr. Keith, MPI's road safety programs are not evaluated exclusively in financial terms. MPI also considers whether a program could impact human toll.[298]

417 Ms. Kroeker-Hall considered MPI's approach to be appropriate. In her May 21, 2015 assessment, Ms. Kroeker-Hall observed[299]:

> *There are no precise guidelines about the maximum percentage of a scheme budget that is worth spending on an efficiency or effectiveness assessment. But expenses for the efficiency assessment should be in proportion to the project scale and especially to the financial budget that is underlying the implementation process of the safety measure.*

418 At the hearing, Ms. Kroeker-Hall elaborated that when budgets are capped, there is less flexibility to consider changes in priorities or new initiatives. She characterized MPI's approach as demonstrating " a somewhat unique commitment to road safety compared to the other jurisdictions that I've reviewed."[300]

419 CAC observed that the road safety budget of ICBC and SGI exceed MPI's budget. The mandates of those utilities differ in material respects from MPI's mandate, particularly with respect to funding of law enforcement and infrastructure

[296] MPI Exhibit 1: Volume I, LP.1, page 7
[297] T: 171, 13-17
[298] T: 1342
[299] MPI Exhibit 52: page 6
[300] T: 1081, 11-13

projects.[301] It is also notable that MPI's loss prevention and road safety budgets are not capped.

11.4 Programs Directed at Cyclists

420 MPI's road safety portfolio includes appropriate initiatives directed at vulnerable road users, including cyclists. MPI educates and raises awareness of both cyclists and motorists in how to safely share the road.

421 Cyclists benefit from programs including Bike Safe (bike-safety for pre-school children), Cycling Champion (developed and delivered by Bike Winnipeg), Bike Together Winnipeg (provides bicycles, helmets and training to children) and the Bike It! (Commuter Program). Although much of the programming is geared towards children, there is potential for parents and guardians to learn from the contact with this programming as well.[302]

422 Drivers are targeted through incorporation of cycling safety material in the High School Driver Education program and MPI's annual public awareness campaign.[303]

423 MPI has introduced, in the past few weeks, a pilot program for cycling education in grades 4 to 8, as a component of the physical education curriculum. Mr. Keith explained how this program targets children both as cyclists and future drivers[304]:

> *And the intent of this program, again in conjunction with the Bike Winnipeg and Seven Oaks School Division, is to be able to not just instill in -- in these kids cycling skills and cycling safety as cyclists on the road, but also to prepare them as future drivers to have a better sense, a better understanding, a better appreciation for the requirement to give cyclists their -- the -- the space and the respect they need on the roadway so that when they themselves become drivers, they will -- they will be more apt to provide that sort of -- that sort of respect to cyclists and -- and do their part to -- to avoid collisions with cyclists.*

[301] T: 1075, 22-24
[302] MPI Exhibit 1: Volume I, LP.3.4, pages 24-25
[303] MPI Exhibit 1: Volume I, LP.3.4, pages 25
[304] T: 956, 19 - 957, 6

11.5 Addressing Wildlife Collisions

424 MPI recently undertook an in depth assessment of all types of existing and promising loss prevention concepts to address collisions with wildlife. MPI produced a report in April 2016 entitled Wildlife Collision Mitigation Review and Cost Benefit Analysis.[305] The study validated MPI's current approach.

425 Increased public awareness in identified hot spots was found to be "an effective tool to change driver perception of the potential risk and raise awareness on the roadway.[306] Expanded use of variable message signs in more hotspot locations was also recommended.[307] This is a relatively cost effective measure and represents an expansion of current programming which can be implemented for the 2016 fall season when deer activity is most prevalent.[308] Public awareness and education initiatives have value as cost-effective tools for addressing wildlife collisions in Manitoba.

426 CMMG favors fencing, which research shows can be very effective in the areas where it is used. However, a cost-benefit analysis of fencing revealed this solution to be cost-prohibitive for widespread use in Manitoba. Given Manitoba's environment there is also an expectation that wildlife may find a non-fenced area to cross, thereby simply moving the hot spot.[309] Fencing also has implications for wildlife habitat and migration.[310]

427 CMMG highlighted the apparent disparity in magnitude of the impact of wildlife collisions, against the budget allocated to address it, suggesting the $65 thousand was not sufficient to address a $30 million problem. MPI submits that this is an incomplete and therefore inappropriate take on the situation. MPI has prepared a detailed survey[311] of the costs and benefits of specific solutions to wildlife collisions. This thorough and detailed analysis reveals that cost of the fencing and/or large

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305 MPI Exhibit 1: Volume I, LP, Attachment E
306 MPI Exhibit 1: Volume I, LP, Attachment E, page 4
307 MPI Exhibit 1: Volume I, LP, Attachment E, page 4
308 MPI Exhibit 1: Volume I, LP, Attachment E, 26
309 MPI Exhibit 1: Volume I, LP, Attachment E, page 3
310 T: 1391
311 MPI Exhibit 1: Volume I, LP, Attachment E, page 21-23

animal detection systems solutions are too high. It would not be prudent for the Corporation to pursue solutions that do not have a reasonable prospect of payback. The Corporation is actively deploying the wildlife collision mitigation measures which are cost effective, in the context of Manitoba's wildlife collision hot spots.

428 Large animal warning and detection systems were found to be cost-prohibitive considering the cost of the system, and system repairs and upgrades.[312]

429 Mr. Keith spoke about[313] new vehicle technologies that have been implemented and are being developed by manufacturers that are expected to greatly reduce wildlife collisions. Automated braking technology, adaptive cruise controls and lane departure warning systems are appearing in new vehicles today. One promising development expected to be implemented in the near future is infrared technology that will "see" wildlife on the side of the road and alert the driver or signal the vehicle to take evasive action to prevent a collision. These technologies are anticipated to be more effective than the current environmental systems used to decrease wildlife collisions.

430 In light of the findings of MPI's research, it is appropriate to maintain MPI's focus on proven public awareness and education initiatives[314] and MPI has in fact moved forward with the recommendation for increased public awareness and additional hot spot research.[315]

11.6 Motorcycle Portion of Road Safety Budget

431 CMMG was dismissive of MPI's spending when it comes to motorcycles. MPI submits that the evidence shows an appropriate focus on this group of policyholders.

[312] MPI Exhibit 1: Volume I, LP, Attachment E, page 3-4
[313] T: 1392-1393
[314] MPI Exhibit 1: Volume I, LP.4.13, page 63
[315] T: 1060, 1-4

432 First, Mr. Keith observed that the amount of per unit spending for motorcycles exceeded that for vehicles generally[316]:

> *These numbers will change slightly. But we responded last year that, on a per-vehicle basis, total spending on all road safety programming is forecast – forecasted at $10.43 per vehicle compared to $13.29 per motorcycle on motorspl – motorcycle specific initiatives*
>
> *So those numbers will change based on the rates this year and the spending this year, but we would not expect the proportion to change.*

433 Second, effective general Road Safety initiatives aimed at altering or influencing driver behavior – such as distracted or impaired driving – necessarily have positive effects on the motorcycling community as a segment of road users.[317]

11.7 TCSR Data is Relevant and Comparable

434 Bike Winnipeg argues MPI's initial objection to providing Enterprise Data Warehouse (EDW) data presumes that the PUB doesn't require timely data. This is incorrect. MPI's objection was based on concerns about the inclusion of irrelevant data for the purposes of road safety (e.g. out of province), but MPI had offered to make the data available in the context of stakeholder committee. MPI has provided the PUB with relevant and comparable data, that is used by jurisdictions throughout the country. Comparability with other jurisdictions is a recurring theme proffered by interveners, and MPI's reliance on the data that is cross jurisdictional is consistent with this theme.

11.8 Road Safety Summary

435 MPI has demonstrated its commitment to Road Safety and continues to set priorities in accordance with a comprehensive framework that ensures proper funding of effective programs.

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[316] T: 1379, 7 - 1380, 10
[317] T: 1372

12.0 Other Matters

12.1 Accepted Actuarial Practice

436 Most elements of MPI's current ratemaking methodology accord with Accepted Actuarial Practice (AAP).[318] The two areas of departure are intentional, and reflect MPI's long-standing mandate to achieve break even net income. The current methodology has served Manitobans well for decades, and it is important for all stakeholders to understand the implications of such a change.

437 MPI's mandate to achieve breakeven net income, and the resulting methodology, were developed over 20 years ago. The PUB has applied this methodology with full knowledge of where it necessarily departs from AAP[319]:

> *MR. LUKE JOHNSTON: So the current approach is again based on this net income methodology. So regardless of the profitability of that particular group of policies, our premium request to the regulator is always going to be to restore breakeven net income. So I've talked about that a little bit in the past.*
>
> *Regardless of -- like the Corporation understands actuarially-based rate setting. It's not that we don't understand how to do that, subject to some collaboration that has to occur. But the original reason for shifting to this break even methodology was specifically to meet that mandate of constantly breaking even.*
>
> *So I believe it's in the 1992 rate application we talked about actuarially-based rates. And then we said, Okay, well, we have a bunch of other funds in the bank for investment purposes, the RSR. What do you do with that money?*
>
> *Like if -- you know, if -- if the Corporation is supposed to break even, and you perfectly set the -- the price for the policies you're issuing but you earn investment income on other funds such that you don't break even, how do you set the rates properly so that the Corporation will break even on a net income basis?*

[318] MPI Exhibit 1: Volume III, AI.9, Actuarial Standards Compliance
[319] T: 696, 1 - 697, 4

And the methodology derived was the current one which -- which forces us to always apply for a net income of zero.

438 A complete AAP methodology would require MPI to develop a revised definition of “break even”. AAP based rates are not based on a net income or financial statement view, which has been the basis to assess what constitutes “break even” for many years. Therefore, it is important to understand whether the original rationale for the current methodology remain valid: As noted by Mr. Johnston[320]:

That's never how we've -- we've done things before. We've always kind of, you know, tracked net income to break even. So all we're saying is that we really want to make sure we understand what this means and the methodology to do it and understand some of the potential implications of -- of doing so, and that's -- that's really it.

439 Ms. Reichert also noted that the change could affect government[321]:

MS. HEATHER REICHERT: And again not a -- not from a technical perspective. But again myself not fully appreciating or understanding what this would do to reported net income of the Corporation and knowing that we are consolidated within the overall government consolidated statement, there would need to be discussions with volatility potential in our net income and impacts that that might have on the -- on the Ministry of Finance within the overall government.

440 Ms. Sherry confirmed that the transition to accepted actuarial practice would involve a transitional period, and suggested that the issue would have to be studied further.[322]

441 In light of these considerations, the most appropriate course of action is for MPI to collaborate with the PUB and stakeholders on this issue outside of the GRA process. Mr. Johnston emphasized the importance of continuing to collaborate[323]:

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[320] T:700, 10-16
[321] T: 704, 13-21
[322] T: 2008, 18-23

MS. CANDACE GRAMMOND: So, Mr. Johnston, would you agree that the collaborative process on this point needs to continue?

MR. LUKE JOHNSTON: Yes, absolutely. This is -- this point and the other ones are crucial points in the MPI rate-making methodology, which has been the same for -- for decades.

So we -- the Corporation is very cautious to change that methodology, so we absolutely want to collaborate and make sure everybody understands the imp -- implications of any changes.

12.2 Motorcycle Rates

442 MPI's proposal to use the most recent nine years of experience, instead of the normal 10 year period, is appropriate in the current unique circumstances. The existing methodology, based on 10 years, continues to be appropriate thereafter as a means of enhancing rate stability.

443 The standard approach to motorcycle rating uses 10 years because the longer period tends to smooth out rate volatility. This year, the application of the 10 year average would likely result in an extreme increase this year, with a significant decrease next year, given that the riding season is essentially over and the class has a favorable experience this year. Mr Johnston explained[324]:

Motorcycles actually average all their injury claims out for ten (10) years because we -- again, trying to stabilize those rates.

However -- and the CMMG has definitely noted this in past hearings -- the 2006 loss year was a very bad one for motorcycles, the worst -- easily the worst year in their history. That happens to be the tenth year of their averaging.

So when we saw this swing in -- in rates, we said, Well, is there anything that we can do to mitigate this and still maintain the credibility of the rate-setting process?

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[323] T: 689, 6-16
[324] T:192, 2 - 193, 3 see also; T: 293, 9 - 294, 3

If you go to the next slide, please. So we looked at two (2) things: obviously the -- the 2006 experience, what would happen if that was no longer used; and then we also looked at the current year to see if motorcycle experience was near budget.

So it -- it is actually below budget. So if we don't change the methodology basically and -- and propose the 8 percent rate increase, the likely impact of that will be next year we'll come back and propose a large decrease.

So in light of this big swing, what we're asking here is to remove that year a year early, and that should hopefully keep the rates stable given that we do have at least some knowledge that this year is fairly close to budget.

444 Mr. Guimond reiterated the importance of the consideration that the riding season is over[325] and MPI knows there has been better than average performance to date[326]:

From a business perspective that did not make sense to us when you know the answer but because of timing, you know, if -- if you stick to the ten (10) year, right, when you know the answer after the riding season then you say to yourself, well, what's the purpose of doing that because you know next year when we're going to be here in June, or you're going to be giving a huge -- you're probably going to be disc -- giving a rate decrease.

So it's important for you, sir, to know that we have the answer. It's just timing now. So what makes sense here? I think that's -- that's the way you got to think about it from a business perspective, because the riding season is over.

445 PUB counsel inquired whether MPI's approach represented a cross-subsidy. Cross-subsidy implies that motorcycles are paying less than their fair share. In these circumstances, where the riding season is essentially over, there is no expectation that motorcycles will be experiencing the costs that would be indicated by the rote application of the 10 year approach.

[325] T: 1589, 1-5; Mr. Guimond's comments were supported by Douglas Houghton in his presentation to the Board
[326] T: 296, 23 - 298, 4

446 In any event, the actuarial standards contemplate that the rate should make sense given the available information. Section 15.50 says: “The actuary should examine the reasonableness of a calculations result”.[327] In this circumstance, it would not make sense to charge a higher rate given that the experience for this year is known to be favorable and it would result in the very volatility the standard methodology is designed to avoid. Mr. Johnston explained:

> *MR. LUKE JOHNSTON: The actuary is -- I -- I guess if there's a methodology that is -- that -- that we use and we support, and as I've just mentioned, if there's a case where there's some kind of unfairness or inequity created by using that meth -- methodology, I wouldn't expect the actuary to in all cases just demand use of that methodology under all circumstances.*
>
> *This, we believe, is a special case where it does make sense for the Corporation to apply for a -- a different rate. But again, with caution when we do talk about break even, we're talking about break even over the long term. And this is a volatile class, so we make this recommendation -- sorry, we want to note that it's a very unique circumstance, and that's why we're -- we're asking for this.*

447 CMMG was critical of the fact that MPI had not adjusted for the poor experience in prior years. MPI submits that recognizing that poor experience has made sense to this point, and 10 years will remain the appropriate horizon going forward. It will best ensure rate stability in normal circumstances[328]:

> *MR. LUKE JOHNSTON: Yes, I'm -- I'm assuming that you've intentionally selected the favorable loss ratios out of that group as you skipped the lines with the higher ones. But the -- I see your point that the loss ratio is low.*
>
> *And the reason we look over a longer period for motorcycles is because of the -- the volatility in these results, as you can see in this particular example, ranging from a very favorable year, 44.26 percent loss ratio all the way up to 156 percent. So we look at longer periods from a rate stability perspective. That's the reason.*

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[327] T: 891 7-893, 23
[328] T: 883, 11-884, 3

448 CMMG, in its closing statements[329], argued that the Corporation has finally come around to recognizing the 'equity in excluding the outlier'. The Corporation does not share this interpretation of why it made the adjustment to motorcycle rates that it did. The adjustment is intended to reduce volatility in motorcycle rates that is anticipated as a result of the current riding season being effectively over. The Corporation stands behind its general ratemaking approach, and as articulated throughout this hearing, is targeting rate stability where an opportunity to do so exists.

449 It is worth noting that CMMG's apparently preferred approach of using a short term horizon is only beneficial to motorcyclists when there has been a long period of favorable claims experience. The approach they are recommending would have resulted in very significant rate spikes in the years immediately following 2006, for instance. MPI submits that it is in the interest of motorcyclists to continue to use an approach that promotes rate stability.

450 Mr. Houghton, who is also a director of CMMG, noted that the CMMG and MPI have a good working relationship with the Corporation. The two organizations have different perspectives and they do not necessarily always agree, but the relationship at the operational level is respectful. Mr. Houghton's proposals are one area where MPI will respectfully have to agree to disagree. Part of Mr. Houghton's proposals go beyond the role of the PUB in this GRA proceeding.

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[329] T: 2143, 23-25

13.0 Conclusion

451 Two key issues in this Application – capital adequacy and interest rate forecasting – have been the subject of debate for some time and have occupied significant time at the Board's recent hearings. It is in the interests of all stakeholders to bring resolution to those issues. MPI's rate and RSR proposals in this Application will position MPI to meet the challenges facing the Corporation while maintaining rate stability. The proposals are just and reasonable and should be approved as sought.

452 The interveners' heightened interest in second-guessing the current investment strategy misses the mark and fails to recognize (i) the fact that matching claims liabilities accounts for almost ¾ of the portfolio; and (ii) the significant implications that the ongoing uncertainty on rate and capital adequacy has had on MPI's investment strategy. One cannot have both low risk and high reward. Approving MPI's proposals, and resolving that uncertainty going forward, will position MPI and the Department of Finance to entertain modifications to the strategy in the next scheduled ALM study. Undertaking another ALM at this point, without resolving the key structural issues constraining MPI's ability to take on more risk, is not a good use of funds.

ALL OF WHICH IS RESPECTFULLY SUBMITTED.