

## MANITOBA PUBLIC UTILITIES BOARD

Re: MANITOBA PUBLIC INSURANCE CORPORATION (MPI)  
GENERAL RATE APPLICATION  
2014/15

Before Board Panel:

Karen Botting - Chair  
Regis Gosselin - Board Chair  
The Hon. Anita Neville - Board Member

HELD AT:

Public Utilities Board  
400, 330 Portage Avenue  
Winnipeg, Manitoba  
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Pages 633 to 844



“When You Talk - We Listen!”



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1 --- Upon commencing at 9:29 a.m.

2

3 THE CHAIRPERSON: Good morning,  
4 everyone, and welcome back to our next week of  
5 hearings. And I would also like to welcome Ms.  
6 McLaren back, and I was -- we were wondering how your  
7 sleepover went?

8 MS. MARILYN MCLAREN: Not so much  
9 sleeping. Knowing that I didn't have to testify the  
10 next day, unlike last year, I guess I wasn't quite as  
11 motivated. But it was really, really noisy and  
12 really, really bright. I'm sure there was a street  
13 cleaning machine that just circled the block all night  
14 long. There's way more semi trailers that seem to run  
15 right through the centre of the city at night than  
16 they do during the day.

17 But it was also very enlightening.  
18 There were people -- homeless people who came and --  
19 and met, and discussed with the group again. The --  
20 the effort exceeded its fundraising goal. It -- it  
21 was a really busy place at the corner of Portage and  
22 Main that night. It was a really good event. Thank  
23 you for asking.

24 THE CHAIRPERSON: Okay. Thank you.  
25 You'll get -- get a whole new view of vehicles on the

1 road.

2 MS. MARILYN MCLAREN: Exactly

3 THE CHAIRPERSON: Okay. Yes, thank  
4 you. We're going to start this morning with Ms.  
5 Grammond doing cross-examination, and we're going to  
6 begin with you, Ms. Grammond.

7 MS. CANDACE GRAMMOND: Thank you,  
8 Madam Chair. Oh, yeah, of course.

9 MS. KATHY KALINOWSKY: Actually, this  
10 morning we'd like to start with my -- myself, and we  
11 do have an exhibit to file this morning. And judging  
12 by the numerous requests for it, it's a really hot  
13 commodity and it's bound to be a best seller. It's  
14 the Deloitte IFRS reports. And it's three (3)  
15 different reports but we'll mark them together as MPI  
16 Exhibit number 10.

17 So it's the IF -- IAS-19R report  
18 (phonetic), and then attached to that is a cover  
19 letter from Deloitte which is an update. And then the  
20 next report is IFRS 4 Phase 2. And the next report is  
21 IFRS number 9. So with that, we can mark those  
22 altogether as Exhibit number 10.

23

24 --- EXHIBIT NO. MPI-10: Deloitte IFRS reports

25

1 THE CHAIRPERSON: Thank you. And, I'm  
2 sorry, I did not welcome our actuary, Brian Kelly. So  
3 welcome, from Toronto.

4 MS. CANDACE GRAMMOND: Thank you.

5

6 MPI PANEL:

7 MARILYN MCLAREN, Resumed

8 HEATHER REICHERT, Resumed

9 LUKE JOHNSTON, Resumed

10

11 CONTINUED CROSS-EXAMINATION BY MS. CANDACE GRAMMOND:

12 MS. CANDACE GRAMMOND: So, Mr.

13 Johnston, now that we have Mr. Pelly here, I'm going  
14 to be dealing in the main with actuarial matters  
15 today, so I hope you had your Wheaties 'cause it could  
16 be a long conversation.

17 I'm going to ask you to go to PUB/MPI-  
18 1-41. It's not in the book. But if you could turn  
19 there, we'll be referring a little bit to that  
20 response in these upcoming questions.

21 MR. LUKE JOHNSTON: I'm there.

22 MS. CANDACE GRAMMOND: So in 1-41 --  
23 and I'll just -- is -- make sure that the panel's  
24 there.

25



1 (BRIEF PAUSE)

2

3 THE CHAIRPERSON: Thank you, we're  
4 good.

5

6 CONTINUED BY MS. CANDACE GRAMMOND:

7 MS. CANDACE GRAMMOND: So this was a  
8 question relative to the statement of principles  
9 regarding property and casualty insurance rate-making  
10 adopted by the Casualty Actuarial Society, and as well  
11 with respect to the standards of practice of the  
12 Canadian Institute of Actuaries, including Section  
13 2600.

14 And in the response to this IR the  
15 Corporation provided a copy of Standard of Practice  
16 2600, which is the attachment, and in particular in  
17 section 2620.01, which we find at the bottom of page  
18 2,078, we see the following reflected under 'Method',  
19 quote:

20 "The best-estimate present value of  
21 cashflows relating to the revenue at  
22 the indicated rate should equal the  
23 best-estimate present value of  
24 cashflows relating to the  
25 corresponding claims costs and

1 expense costs plus the present value  
2 of a provision for profit over a  
3 specified period of time."

4 Is that right?

5 MR. LUKE JOHNSTON: Yes, that's  
6 correct.

7 MS. CANDACE GRAMMOND: Now, I  
8 understand that the CIA, or Canadian Institute of  
9 Actuary Standards, defines the term 'best estimate',  
10 as, quote:

11 "Without bias, neither conservative  
12 nor unconservative."

13 Is this definition consistent with the  
14 basis on which the GRA rate indications have been  
15 prepared?

16 MR. LUKE JOHNSTON: Yes, it is.

17 MS. CANDACE GRAMMOND: And are there  
18 any exceptions to the best-estimate objective  
19 underlying the GRA rate indications?

20 MR. LUKE JOHNSTON: None that I'm  
21 aware of.

22 MS. CANDACE GRAMMOND: Now, you have  
23 stated that the GRA rate indications have not been  
24 prepared in compliance with Section 2600 of the CIA  
25 standards.

1 Is that correct?

2 MR. LUKE JOHNSTON: Yes.

3 MS. CANDACE GRAMMOND: And can you  
4 advise of in what respect the GRA analysis is not  
5 compliant with acceptable actuarial practice in  
6 Canada?

7 MR. LUKE JOHNSTON: So I'll admit I --  
8 I struggled a little bit with this answer. There's no  
9 question that our rating procedures follow actuarial  
10 principles, their best estimates. We clearly outline  
11 the costs, expenses, all -- everything associated with  
12 determining our required rate in our -- in our rate-  
13 making section.

14 Specific to the -- the very specific  
15 wording in the standard, we do do things slightly  
16 different at MPI. We are attempting to set breakeven  
17 rates in the rating period. And that requires that,  
18 of course, we -- we determine all the costs -- the  
19 premiums and costs, et cetera, in the rating period  
20 and cov -- with an overall rate that breaks even for  
21 us.

22 What I alluded to in -- in this  
23 response was that there was a time where we did  
24 attempt to do a procedure, basically as described in -  
25 - in here. But in the end we always had to balance

1 back to breakeven rates. And one (1) of the -- one  
2 (1) of the big pieces of that is the investment  
3 income.

4                   We -- we have a very large asset base  
5 and -- and it earns investment income that far exceeds  
6 the amounts that we would get purely from discounting  
7 all the -- the cashflows. So that's -- that's one (1)  
8 reason why we do it the way that -- that we do, so.

9                   I don't have any -- again, I don't have  
10 any issues with how we calculate rates, but in -- to  
11 meet our mandate we need to make an adjustment to  
12 specifically the -- the claims cost portion so we  
13 break even.

14                   MS. CANDACE GRAMMOND: Thank you, Mr.  
15 Johnston. Would it be fair to say that the GRA  
16 analysis seeks an estimated equilibrium between  
17 revenues and costs for an accounting period, whereas  
18 accepted actuarial practice in Canada would seek this  
19 estimated at equilibrium for an underwriting period,  
20 i.e., for policies issued during a specified calendar  
21 period?

22                   MR. LUKE JOHNSTON: That's right. And  
23 that's maybe a better -- a quicker summary of what I -  
24 - what I just stated. The -- that is the -- the goal  
25 that we are always trying to achieve with our rate

1 applications, to -- to break even in that fiscal  
2 period.

3 THE CHAIRPERSON: Could you -- Ms.  
4 Grammond, could you repeat what you just said, so --

5 MS. CANDACE GRAMMOND: Absolutely.

6

7 CONTINUED BY MS. CANDACE GRAMMOND:

8 MS. CANDACE GRAMMOND: So I think we  
9 were trying to sum up Mr. Johnston's earlier answer.  
10 So the question was, Would it be fair to say that the  
11 analysis done in the GRA seeks an estimated  
12 equilibrium between revenues and costs for an  
13 accounting period, whereas the accepted actuarial  
14 practice in Canada would typically seek this estimated  
15 equilibrium for an underwriting period. So accounting  
16 period versus underwriting period.

17 MR. LUKE JOHNSTON: And I confirm  
18 that.

19

20 (BRIEF PAUSE)

21

22 MR. REGIS GOSSELIN: For the non-actu  
23 -- actuaries in the room, could you -- could you drill  
24 down even more than that, accounting period versus  
25 actuarial period, explain that to me, Mr. Johnston,

1 please?

2 MR. LUKE JOHNSTON: Sorry, could you  
3 repeat that? I didn't hear every word...

4 MR. REGIS GOSSELIN: Well, I just --  
5 to -- in relation to the accounting period versus the  
6 actuar -- actuarial period, could you explain that for  
7 us, please?

8 MR. LUKE JOHNSTON: So if, outside of  
9 MPI, the standard actuarial practice would -- you  
10 would consider a particular group of policies. And  
11 you would look at all the -- the costs, expenses, et  
12 cetera, with those policies, determine a appropriate  
13 investment return assumption, present value, all those  
14 costs and expenses to -- to the -- the policy issuance  
15 period, and then determine your rate based on -- on  
16 that. And -- and you would typically add a profit  
17 load to that if you were a private insurer.

18 If -- if MPI did that, we haven't done  
19 the exercise yet, but my expectation would be that we  
20 would have what would show as -- needing -- we need a  
21 rate increase likely, because the costs and expenses  
22 associated with just the policies we're issuing  
23 wouldn't consider the substantial amount of investment  
24 income that we're earning on our unpaid claim  
25 liabilities, retained earnings, et cetera.

1                   And that was -- that was the main  
2 reason to switching to the accounting-basis-type  
3 approach. So what we're -- when you're looking at the  
4 statement of operations and -- and the Corporation is  
5 saying, Well, we took the average of the two (2) years  
6 to break even, that's the -- that accounting basis.  
7 And it's not -- those are definitely our best-estimate  
8 projected costs, no question about that.

9                   But to meet our mandate, we're -- we've  
10 -- we've changed our procedures, so that's the  
11 objective to break even there, rather than, you know,  
12 discounting, you know, all the policy costs to some  
13 amount.

14                   The way, like, one (1) potential way  
15 around it would be to say, you know, Here's -- here's  
16 the expected value of just those policies, now what  
17 adjustment do we need to make to break even? Like,  
18 maybe that's, you know, you have to lower it by 5  
19 percent or something. That's not the way we've --  
20 we've traditionally done it. That's another potential  
21 option.

22

23 CONTINUED BY MS. CANDACE GRAMMOND:

24                   MS. CANDACE GRAMMOND: Thank you.

25 Now, Mr. Johnston, the response here at PUB/MPI-1-41A

1 takes us back to the 1992 rate application to learn  
2 the rationale for the rate-making approach followed in  
3 the GRA.

4 Can you comment on that and outline  
5 that rationale?

6 MR. LUKE JOHNSTON: Perhaps the best  
7 summarization is for me just to read in the -- the  
8 page 2 quote from that application. And it states  
9 there:

10 "Using this method, the resulting  
11 required premium is higher because  
12 only investment income earned from  
13 the current year's policies is  
14 accounted for. For example,  
15 investment income from retained  
16 earnings is not used as a premium  
17 offset. Due to the Corporation's  
18 nonprofit mandate, this income  
19 should be used as a prima offset  
20 and, therefore, the method described  
21 under section 2.3.1, i.e. the  
22 Corporation's current rate-making  
23 methodology, is more consistent with  
24 the goals of the Corporation."

25 End quote. So that -- that's



1 essentially a summary of what I just described in your  
2 question.

3 MS. CANDACE GRAMMOND: Now, can you  
4 tell us whether this approach, as you've described,  
5 originated with MPI, or whether that approach was  
6 created more so in the context of the regulatory  
7 process of that time?

8

9 (BRIEF PAUSE)

10

11 MR. LUKE JOHNSTON: I don't -- I don't  
12 know the answer to that question, but we can look --  
13 we can dig a little bit and see if that originated  
14 from the actuary internally at the time, or if it was  
15 driven by a -- a -- like the regulator, for example.

16 MS. MARILYN MCLAREN: If I could, Ms.  
17 Grammond, I find I'm starting way too many sentences  
18 these days with 'I remember when'.

19 But I do remember the first time Mr.  
20 Pelly was supporting the Board in these proceedings.  
21 And I remember one (1) of those off-microphone  
22 conversations between our chief actuary at the time,  
23 Don Palmer, Mr. Pelly, and myself talking about  
24 exactly this issue and Mr. Pelly struggling with the  
25 concept of why all that investment income was in our

1 rate-making methodology as an offset to revenue.

2                   And again, it -- the conversation, you  
3 know, for reference, maybe after -- you -- you might  
4 want to tie back to that rate-making methodology page  
5 that I referred to last week. It was one (1) of my  
6 very favourite pages in the application, where it --  
7 it shows investment income being a significant offset  
8 to the revenue required and Mr. Pelly basically  
9 saying: But I -- I don't understand why -- why would  
10 you do that. Why are you putting that rev -- that  
11 investment income revenue into your revenue  
12 requirement calculations for a going-forward year?

13                   And basically what Mr. Palmer and I  
14 were saying is, What else would we do with it? That  
15 is one (1) of the significant benefits of the public  
16 auto insurance system, is that investment income,  
17 there is no return to shareholders per se. That is a  
18 direct offset that lowers the cost of auto insurance  
19 in Manitoba by putting that investment income as a  
20 reduction to what people would otherwise have to pay  
21 for their AutoPac rates.

22                   So that's basically how we've done it  
23 since well before that year, when Mr. Pelly joined us.  
24 And it is really from -- it's the best presentation  
25 that we have, and the simplest presentation, of that

1 principle of public auto insurance and how we actually  
2 do calculate our revenue requirement.

3 We could do like Mr. Johnston said.

4 And if the Board feels that's important, we could do  
5 that. We could show that we have 5 percent less  
6 revenue coming in. And then we would have to give a 5  
7 percent discount because we've then recognized the  
8 revenue. But nobody wants us to make money. And we  
9 need to have a breakeven presentation.

10 So that's how we've done it for a very,  
11 very long time. It ties directly to the -- the  
12 principle of one (1) of the values of public auto  
13 insurance.

14

15 (BRIEF PAUSE)

16

17 MR. REGIS GOSSELIN: I suppose the  
18 follow-up question would be: If we were to do it  
19 another way, what would it mean for rates?

20 In other words, which -- which method  
21 would yield the -- the most variability in terms of  
22 rate making? I mean, I -- I think --

23 MS. MARILYN MCLAREN: Well --

24 MR. REGIS GOSSELIN: I think  
25 stability's a goal. That's all our goal is right

1 there, to share some rate stability. But I guess I'm  
2 wondering, if we were to choose an alternative method,  
3 what does it mean for the rates in terms of  
4 variability?

5                   One (1) of the gains would obviously be  
6 that you would have an actuarial statement without  
7 qualification?

8                   MS. MARILYN MCLAREN: I -- I think the  
9 short answer is we can't -- we can't do it another way  
10 that impacts rates. It would be really  
11 counterintuitive for -- for the -- in the interest of  
12 rate stability if we somehow didn't include it at all,  
13 raised rates by, you know, between 5 and 10 percent,  
14 and collected up a bunch of money and then used it to  
15 give a rebate or something like that.

16                   I mean, at the end of the day, we have  
17 to -- I believe we have to propose, you have to  
18 approve rates that create that breakeven circumstance.  
19 Do we show it differently? Do we go through a couple  
20 of extra steps? Do we add a bit of complexity to the  
21 rate methodology process?

22                   If there's value in that, I guess we  
23 could think about doing that, but as long as we  
24 understand what we're doing and why and how in every  
25 other way this is highly consistent and -- and within

1 and follows tightly actuarial guidelines. I -- I  
2 don't think -- I don't think we want to start talking  
3 about actually impacting Manitobans differently.

4 It is -- you know, it -- it's part of  
5 the process. It's their money. They deserve to have  
6 that offset to the premiums they pay. How do we want  
7 to present it? How do we want to talk about it?

8

9 CONTINUED BY MS. CANDACE GRAMMOND:

10 MS. CANDACE GRAMMOND: So here's a  
11 question then. The CIA standard makes reference to,  
12 quote, "provision for profit," end quote. Through the  
13 appropriate setting of that provision wouldn't it be  
14 possible to develop a rate indication that is  
15 compliant with the CIA standard and that would stay  
16 true to the Corporation's breakeven mandate but that  
17 would recognize that investment income -- recognize  
18 the investment income expected to be earned from  
19 retained earnings?

20 MR. LUKE JOHNSTON: Yeah, I think it's  
21 somewhat similar to what we -- we just discussed. If  
22 you've calculated everything exactly as described in  
23 the standards, you'd be left with some extra money  
24 from investment income. And then you can call that  
25 whatever you want, negative profit or just an off --

1 off-balance adjustment.

2                   The -- the caution I -- with -- in  
3 answering the question, we would need some time to  
4 really understand what that means. And, so I think  
5 everybody agrees that however it's calculated, we'd  
6 want a breakeven net income as we do today. The  
7 implications -- so that would mean the same overall  
8 rate.

9                   But the implications within each major  
10 class, I'm not fully certain what that means yet, so  
11 it -- it would, after these hearings, be nice to under  
12 -- understand that better before I comment on that too  
13 much.

14

15                   (BRIEF PAUSE)

16

17                   MS. CANDACE GRAMMOND: Mr. Johnston,  
18 can you comment on a little bit further your statement  
19 about impact varying by major class, because we are  
20 talking about the overall rate indication, right?

21                   MR. LUKE JOHNSTON: The -- if -- if  
22 you're changing how you look at all the expected costs  
23 and expenses with a particular group of policies, it's  
24 possible that it -- it could change the underlying  
25 indicated rate for different groups. You'd also have

1 to consider how that ending investment income,  
2 adjustment applies to the different classes.

3                   There's -- what I'm really saying is  
4 that there's a lot things we might have to re-look at  
5 if we're going to rate that way, and understand that  
6 we're doing it appropriately.

7                   MS. CANDACE GRAMMOND: Thank you.  
8 Now, you may wish to answer the following question by  
9 way of undertaking, and -- and if so, feel free to  
10 say.

11                   Can you tell us what your intuitive  
12 expectation would be as to whether a rate indication  
13 calculated in accordance with accepted actuarial  
14 practice in Canada would be higher than, the same as,  
15 or lower than that which is now applied for, given  
16 today's claims, economic, and investment climates?

17                   MR. LUKE JOHNSTON: Probably best I  
18 take that as an undertaking. Thanks.

19                   MS. CANDACE GRAMMOND: Thank you.

20

21 --- UNDERTAKING NO. 22: MPI to provide what its  
22 intuitive expectation  
23 would be as to whether a  
24 rate indication calculated  
25 in accordance with

1                   accepted actuarial  
2                   practice in Canada would  
3                   be higher than, the same  
4                   as, or lower than that  
5                   which is now applied for,  
6                   given today's claims,  
7                   economic, and investment  
8                   climates

9

10 CONTINUED BY MS. CANDACE GRAMMOND:

11                   MS. CANDACE GRAMMOND:     Now, Mr.  
12 Johnston, I understand that the CIA standards of  
13 practice permit deviating from the accepted actuarial  
14 practice under any of four (4) different  
15 circumstances: the first, conflict with law; the  
16 second, conflict with the terms of an appropriate  
17 engagement; the third, unusual or unforeseen  
18 circumstances; and the fourth, materiality.

19                   Would you agree?

20                   MR. LUKE JOHNSTON:     Those sound  
21 correct. I agree.

22                   MS. CANDACE GRAMMOND:     And can you  
23 tell us under which of those four (4) circumstances  
24 you have deviated from act -- accepted actuarial  
25 practice in Canada for this GRA?



1 MR. REGIS GOSSELIN: Would you mind  
2 repeating those four (4) elements? That'll give a  
3 chance for Mr. Johnston to think about his answer.

4 MS. CANDACE GRAMMOND: For sure. Mr.  
5 Chairman, the four (4) areas are conflict with law.  
6 Second is conflict with the terms of an appropriate  
7 engagement. The third are unusual or unforeseen  
8 circumstances. And the fourth is materiality.

9

10 (BRIEF PAUSE)

11

12 MR. LUKE JOHNSTON: Okay. So I'll go  
13 through each of these, the four (4) that were listed.  
14 Con -- conflicts with -- with law, there is -- I don't  
15 know if 'law' is the right word, but if -- my view is  
16 that if -- if we -- at the regulatory process we agree  
17 on our rate-making procedure that the regulator  
18 approves, I would be expected to follow that  
19 procedure.

20 If it was -- happened to be a case  
21 where it was different from standards of practice,  
22 that I would -- that could be noted. There's not --  
23 there's nothing here saying I have to -- I have to  
24 deviate from standards of practice. This is just the  
25 rate-making methodology that -- that we arrived at.

1                   The second one, in terms of the en --  
2 engagement, it is a somewhat unique circumstance.  
3 This is what I'm being asked to do, to -- to set rates  
4 for the public program.

5                   Similar with the third one, unforeseen  
6 circumstances. Again, it's a un -- it's a unique  
7 public setting, breakeven rates. So there are reasons  
8 that we may want to deviate slightly from the  
9 standards as we have, as I already described.

10                   And the fourth, materiality, I -- I  
11 don't see a -- that being relevant.

12

13   (BRIEF PAUSE)

14

15 CONTINUED BY MS. CANDACE GRAMMOND:

16                   MS. CANDACE GRAMMOND:    So, Mr.  
17 Johnston, just to drill into that a little bit  
18 further, if I understand your answer correctly, you're  
19 -- you basically said it's not the first one, conflict  
20 with law. It's not the last one, materiality.

21                   So it would be either the second one,  
22 conflict with terms of appropriate engagement, or the  
23 third, unusual or unforeseen circumstances?

24                   MR. LUKE JOHNSTON:    Yeah, it's a dif -  
25 - it's just a little bit difficult to say exactly

1 which this would fall in, but I -- I think in general  
2 the -- if -- similar to the -- the DCAT, for example,  
3 if -- if our regulatory environment is asking for a  
4 certain -- things to be honoured a certain way, we set  
5 rates, you know, this way based on an agreed PUB-  
6 approved methodology that we've used for many years.

7           If -- if that deviated from standards  
8 and I was to -- to sign off on the rates, I -- I would  
9 note that -- that in this particular case we don't  
10 follow the standards, you know, as a result of the --  
11 the -- I guess the prescribed way that we calculate  
12 rates at -- in Manitoba.

13           MS. CANDACE GRAMMOND:    So I -- Mr.  
14 Johnston, again, just to try to pare this down a  
15 little bit, I'm -- I'm prepared to share with you that  
16 we thought you were going to say conflicts with the  
17 terms of an appropriate engagement because of the  
18 rate-mething -- rate-making methodology that in place  
19 it wouldn't seem to be unusual or unforeseen as far as  
20 the Corporation's concerned.

21           So would -- would you agree that it  
22 probably more so falls under the second category of  
23 conflicts with the terms of the -- of your engagement?

24           MR. LUKE JOHNSTON:    That's fair.  
25 Agree.

1 MS. CANDACE GRAMMOND: Now, I  
2 understand that under that exception of the terms of  
3 an engagement, the actuary is expected to, if  
4 practical and useful and appropriate under the terms  
5 of the engagement, report the result of applying the  
6 accepted actuarial practice.

7 Assuming that you would agree with the  
8 usefulness and appropriateness of making such a  
9 disclosure, do you expect it to be practical to do so  
10 in conjunction with next year's GRA?

11

12 (BRIEF PAUSE)

13

14 MR. LUKE JOHNSTON: Yes, I -- I think  
15 it's -- I think it's reasonable to do that. We have --  
16 -- we have agreed, as well, to -- to meet with the  
17 other public insurers to understand how they -- how  
18 their processes are -- how their rate-setting process  
19 is done there. It's my expectation that's something  
20 we could do for next GRA, but we do -- we do need to  
21 investigate it further. We have not done much  
22 analysis at that -- on that at this point.

23

24 MS. CANDACE GRAMMOND: Now, I  
25 understand that the CIA standards anticipate that an  
actuary's opinion would accompany rate indications

1 under certain circumstances.

2 Would -- would you agree with that?

3 MR. LUKE JOHNSTON: Yes.

4 MS. CANDACE GRAMMOND: And do the GRA  
5 rate indications fit within the circumstances of  
6 calling for such an opinion?

7 MR. REGIS GOSSELIN: While -- while  
8 he's developing an answer, could you repeat the -- the  
9 initial question, please?

10 MS. CANDACE GRAMMOND: Sure. This --  
11 this last question?

12 MR. REGIS GOSSELIN: No, the one  
13 before that.

14

15 CONTINUED BY MS. CANDACE GRAMMOND:

16 MS. CANDACE GRAMMOND: Oh, sure. So  
17 the -- the first question was that I understood that  
18 the CIA standards anticipate that an actuary's opinion  
19 would accompany rate indications under certain  
20 circumstances. And I think Mr. Johnston agreed. And  
21 then I asked whether the GRA rate indications fit  
22 within the circumstances calling for such an opinion.

23

24

(BRIEF PAUSE)

25

1 MR. LUKE JOHNSTON: My -- my thinking  
2 is that it would, but I'd like to take that one as an  
3 undertaking, or I could just get back to the Board on  
4 that.

5 MS. CANDACE GRAMMOND: Yeah,  
6 absolutely. Yes, so the undertaking is to advise of  
7 whether the GRA rate indications fit within the  
8 circumstances set out by the CIA standards for calling  
9 for an actuary's opinion.

10

11 --- UNDERTAKING NO. 23: MPI to advise of whether  
12 the GRA rate indications  
13 fit within the  
14 circumstances set out by  
15 the CIA standards for  
16 calling for an actuary's  
17 opinion

18

19 CONTINUED BY MS. CANDACE GRAMMOND:

20 MS. CANDACE GRAMMOND: And, Mr.  
21 Johnston, just for your reference it's Section 2630 of  
22 the standards that that's found within, if that helps  
23 you in the answer.

24 MR. LUKE JOHNSTON: Thank you.

25 MS. CANDACE GRAMMOND: So just a

1 couple more questions on this topic. At last year's  
2 hearing, so the 2012 hearing for the 2013 GRA, in  
3 response to a question on this topic you had advised  
4 that you could certainly look at this issue in the  
5 future. And so we assumed that you did so and -- and  
6 decided that the actuarial opinion would not be  
7 included this year.

8 Can you comment on what considerations  
9 led you to that decision?

10 MR. LUKE JOHNSTON: Is the question  
11 what considerations there were as to why we did not  
12 include that in this year's GRA?

13 MS. CANDACE GRAMMOND: Yes.

14

15 (BRIEF PAUSE)

16

17 MR. LUKE JOHNSTON: So we did -- we  
18 did look at the -- the issue of -- around calculating  
19 rates based fully on actuarial standards. And for  
20 this GRA we -- we didn't have the -- the time or  
21 resources to present rates that way. If we were going  
22 to do so in the future, we would pre -- at least  
23 present rates per actuarial standards of practice.

24 We may not pro -- again, as -- as we've  
25 discussed, we may not propose that rates move in that

1 direction. But in that case, I could provide an  
2 opinion stating that these -- these are the rates that  
3 are calculated per actuarial standards and -- and, as  
4 we discussed again, here -- here are the reasons for -  
5 - that I've deviated from those standards.

6 MS. CANDACE GRAMMOND: Thank you.  
7 Okay.

8 MR. REGIS GOSSELIN: Be -- beyond the  
9 issue of whether or not you're obligated by your  
10 profession to report on that basis, does it represent  
11 a lot of work for you?

12 MR. LUKE JOHNSTON: Pardon me, does it  
13 rep...

14  
15 (BRIEF PAUSE)

16  
17 MR. LUKE JOHNSTON: Yes. Well, my  
18 expectation is, yes, that it does. Again, we haven't  
19 -- haven't started on that, but that's my expectation.

20  
21 (BRIEF PAUSE)

22  
23 CONTINUED BY MS. CANDACE GRAMMOND:

24 MS. CANDACE GRAMMOND: Thank you. So  
25 I'm going to move then into a different actuarial area



1 which relates to forecasting accuracy and the contex -  
2 - context of claims incurred. So I will ask you to  
3 turn to PUB/MPI-1-36, which is not in the Board's  
4 book. So 1-36.

5

6 (BRIEF PAUSE)

7

8 MS. CANDACE GRAMMOND: So we'll start  
9 with (a), which was to file a table for the last ten  
10 (10) years, showing original projected revised  
11 forecast and final actual frequencies broken down by  
12 coverage and for all coverages combined.

13 So if we go to that attachment, 1-  
14 36(a). And I'm going to ask some specific questions  
15 about this. But before we do this, I just want to ask  
16 a couple of general questions that will apply to all  
17 of the tables at this IR. The first one is can you  
18 define the -- the term 'insurance year' which we see  
19 in the heading of the table for the insurance year  
20 ended?

21

22 (BRIEF PAUSE)

23

24 MR. LUKE JOHNSTON: This would be our  
25 fiscal insurance year and the amounts reported in --

1 during that fiscal period.

2 MS. CANDACE GRAMMOND: And for the  
3 Corporation, that fiscal period ends on -- at the end  
4 of February, whether it's the 28th or 29th, in a given  
5 year?

6 MR. LUKE JOHNSTON: Sorry, yes, Mar --  
7 March 1st to February 28th, 29th.

8 MS. CANDACE GRAMMOND: Thank you.  
9 Now, we see for each of the insurance years shown here  
10 the first column is entitled, "Original projected."  
11 And I understand that that represents a first estimate  
12 made at the time of the application for that year.

13 Is that right?

14 MR. LUKE JOHNSTON: That's correct.

15 MS. CANDACE GRAMMOND: So for this  
16 year, that would be the 2014/'15 fiscal year?

17 MR. LUKE JOHNSTON: Yes.

18 MS. CANDACE GRAMMOND: And then the  
19 second column, which is, "Revised forecast,"  
20 represents a second updated estimate made during that  
21 fiscal year.

22 So for right now, that would be  
23 2013/'14, the year we're in?

24 MR. LUKE JOHNSTON: Correct.

25 MS. CANDACE GRAMMOND: Okay, so

1 looking then at the content of this attachment for  
2 (a), can you comment on the forecasting accuracy in  
3 general terms for each of the coverages?

4

5 (BRIEF PAUSE)

6

7 MR. LUKE JOHNSTON: There's -- there's  
8 an IR. I'm just having someone look -- look it up on  
9 -- so these are cover counts as opposed to claim  
10 counts. An injury claim, for example, will have  
11 multiples covers depending on whether they get income  
12 replacement or impairment benefits or -- whereas a  
13 collision will typically just have one (1) cover.  
14 There's not a bunch of other covers associated with  
15 the collision.

16 For PIPP, we -- we have an IR that  
17 talks about some of the issues we've had with our  
18 cover count forecasting in recent years. We had a new  
19 system put in that did a lot of auto reserving of --  
20 of claims, which is great but there's also generating  
21 more covers automatically, which were a bit of an  
22 issue for us. No change in exposure or -- or claims,  
23 but in terms of raw covers more -- more than we -- we  
24 thought.

25 So if you look at '12/'13 year, for

1 example, you see the actual PIPP cover is 86772 being  
2 dramatically higher than -- than those forecast. I  
3 can tell you that the number of claims -- PIPP claims  
4 in that year was really no different than it was in  
5 the last six (6) or seven (7) years.

6                   So one thing that we're -- we're  
7 considering for future versions of this report is to  
8 count claims with -- you know, with that particular  
9 coverage and losses of greater than zero, because  
10 often we also have -- we have someone that comes and  
11 says they're injured, and then they don't report  
12 anything. We still count a cover in here. So we're  
13 trying to find a better basis to -- than covers in --  
14 in this report.

15                   If you look outside of the -- the most  
16 recent years, you see that the trend kind of changes  
17 for -- for PIPP. We had -- or for several years we  
18 were expected PIPP to grow basically with the size of  
19 the fleet, and that hasn't happened. We've actually  
20 had stable to declining PIPP claims experience, and  
21 that's reflected on -- there's some overstatement of  
22 our -- of our cover forecast in -- in prior years.

23                   Moving to collision, again these are  
24 basically just -- there's not multiple covers on  
25 collision. If you go through the collision line, I

1 think I would characterize that as fairly good  
2 performance on -- on predicting cover counts. Winters  
3 are going -- you know, good or bad winters are going  
4 to basically be why -- the main reason why we deviate  
5 from that. Also, bigger than expected changes in  
6 fleet size are -- is another common reason.

7           Comprehensive coverage; theft,  
8 vandalism, fire, those -- those types of things. Just  
9 going through here. In recent years it -- it appears  
10 that we've done -- our actual has come in slightly  
11 lower than our expectations. This isn't too  
12 surprising. I -- our -- our theft program has been  
13 successful, possibly more successful than we thought.  
14 There's be ripple effects to other -- other comprehend  
15 -- comprehensive coverages like attempted theft,  
16 partial theft, vandalism. We've seen all those  
17 categories decline with the auto theft initiatives, so  
18 I'm not too surprised that we came in lower than  
19 forecast on -- on comprehensive.

20           Property damage should basically mirror  
21 collision. We -- we tend to grow property damage  
22 frequency at about the same rate as collision. So  
23 that -- this one also I would call fairly good  
24 forecasting performance over time.

25           And for liability, we're talking really

1 small -- small numbers here. The -- just a quick  
2 glance. It appears we've been maybe a little bit  
3 higher than actual, but very small dollars involved  
4 here.

5

6 (BRIEF PAUSE)

7

8 MR. REGIS GOSSELIN: Just a question  
9 here, I guess, in looking at the -- the PIPP line.  
10 And I noticed that the -- it seems to be that original  
11 projected is save, looking at '12/'13, six (6) to six  
12 nine (6.9), and then you revised it to seventy-three  
13 (73), and the last one is eighty (80) -- eighty-six  
14 (86).

15 And then if you look at the next -- the  
16 previous year to that, it's kind of a similar effect.  
17 You know, the -- the revised forecast tends to be way  
18 out in relation to -- is -- is that just related to  
19 events that might have happen -- happened later in the  
20 year? Is that...

21 MR. LUKE JOHNSTON: I -- I will find  
22 the Information Request on that, but that is almost  
23 completely from the new claims management system. And  
24 a -- a good -- a quick example would be a claim comes  
25 in. It auto reserv -- if -- if the expectation is

1 this type of claim needs chiro -- chiropractic or  
2 physiotherapy, it auto reserves expectations to those  
3 amounts, where in the old world the case manager  
4 would, you know, sit down, look at it, decide which  
5 one they're going to put the money in, or...

6                   So there is multiple cases where we've  
7 got a whole bunch more -- more covers. And we talked  
8 about this issue a little bit in -- in prior hearings  
9 where we actually had a whole bunch more reserves  
10 there as well, which we then subsequently had to  
11 delete.

12                   So that's been the issue with the  
13 couple years. And -- and we've made -- we've made  
14 some changes to a few of these to fix that. So -- so,  
15 for example, with the chiro and physio issue we've  
16 just combined it into one (1) cover now and then the  
17 auto reserves for that and they decide how they want  
18 to split at the -- at the bill item.

19

20 CONTINUED BY MS. CANDACE GRAMMOND:

21                   MS. CANDACE GRAMMOND: Mr. Johnston,  
22 just to inform our review of this document in the  
23 context of your evidence, can you tell us when that  
24 auto-reserving tool was put into place?

25

1 (BRIEF PAUSE)

2

3 MR. LUKE JOHNSTON: September 2010 was  
4 the implementation of BI3 Injury Claims Management  
5 System. I believe all the auto-reserving procedures  
6 also began at that time. But there may, you know,  
7 there may have been, you know, updates or changes made  
8 subsequent to that. But I -- I believe it happened on  
9 that day as well.

10 MS. CANDACE GRAMMOND: So certainly,  
11 Mr. Johnston, based on what we see here and based on  
12 the evidence that you've given, it's the -- the PIPP  
13 coverage that is the most difficult to forecast.

14 Would you agree?

15

16 (BRIEF PAUSE)

17

18 MR. LUKE JOHNSTON: Most -- I don't  
19 know if I'd clari -- say it's most difficult in terms  
20 of covers. We don't -- we -- we take a very long-term  
21 view with PIPP. And in our claims forecasting book  
22 we're -- we're looking at more the historical ultimate  
23 costs of PIPP. Again, I -- I mentioned we found that  
24 it didn't really track with, you know, with units and  
25 vehicle growth, so we've taken a -- a more longer term



1 view.

2 We don't spend a lot of time looking at  
3 covers. At -- at my detail level we look more at  
4 claims, claims open, serious claims, that -- that type  
5 of thing. So in terms of getting it accurate, I agree  
6 with your statement that recent years we've been most  
7 significantly off on -- on covers. But we're trying  
8 to improve that.

9

10 (BRIEF PAUSE)

11

12 MS. MARILYN MCLAREN: If I could just  
13 briefly, the real variability has been the last couple  
14 of years because of a relatively minor shortcoming in  
15 the new system we implemented in September of 2010.  
16 But I think it's important for the Board to understand  
17 that this -- this is something to Board asks for every  
18 year, we provide, but this does not form part of our  
19 formal corporate claims forecasting process.

20 So covers really are -- Mr. Johnson can  
21 correct me, but largely immaterial to the forecasting  
22 process. So this is something that, you know, we'd  
23 liked to have been more accurate. We would have liked  
24 to have got the system right first time out, but it's  
25 not -- it has no impact on our ability to forecast

1 future costs.

2 MS. CANDACE GRAMMOND: Can you comment  
3 on whether -- again, with respect to claim frequencies  
4 or covers, if there's any evidence of systemic bias in  
5 forecasting overall?

6 MR. LUKE JOHNSTON: No, I don't see  
7 it, outside of some of the issues I just described  
8 with PIPP. I don't look at the other -- other lines  
9 and -- and see any bias other than what we later  
10 discovered was, for example, better theft than we  
11 thought, or better -- but no intentional bias in the  
12 forecast.

13 MS. CANDACE GRAMMOND: Thank you.  
14 We'll move then to Attachment C. So if we flip over  
15 the page, we get to 1-36(c) attachment, which is the  
16 claims incurred comparison. So we now are in dollars  
17 as opposed to covers.

18 Is that right?

19 MR. LUKE JOHNSTON: That's right.  
20 That's the -- this would be the curve reported in the  
21 fiscal year.

22 MS. CANDACE GRAMMOND: And this is a  
23 similar kind of table with the original projected, the  
24 revised forecast, and then actual figures?

25 MR. LUKE JOHNSTON: Correct.

1 MS. CANDACE GRAMMOND: And can you  
2 comment on, in a similar way as the last table, the  
3 forecasting accuracy for each coverage?

4

5 (BRIEF PAUSE)

6

7 MR. LUKE JOHNSTON: Okay. I'll start  
8 with PIPP again. If you look at years prior to  
9 2010/'11, you'll notice PIPP almost always -- maybe  
10 always -- just conf -- basically came in significantly  
11 lower than -- than our forecast. As you're also  
12 aware, in the 2010/'11 year, we made substantial  
13 changes to that -- both the forecast and the liability  
14 review, largely in response to this very favourable  
15 development. So definitely there was a trend to PIPP  
16 being lower than our forecast prior to 2010/'11.

17 Since that time, '11/'12 our actual  
18 was, again, slightly lower than our original  
19 projected, but higher than our revised forecast. In  
20 '12/'13, our actual was higher than both our original  
21 projected and revised forecasts. That's the two  
22 twenty-four (224), two ninety (290), compared to two-o  
23 (20) -- 203 million and 204 million.

24 So in -- in general, now that we've  
25 made these changes, we've -- my expectation is you're

1 going to see, you know, sometimes above, sometimes  
2 below. It happens that the last couple of years have  
3 been -- been above, but that -- that's going to happen  
4 with PIPP. You're going to get -- you're going to get  
5 variability in the numbers.

6                   Moving on to collision. Collision --  
7 the severity of a collision doesn't change much in op  
8 -- in -- in present-day dollars. So, again, you're  
9 going to see some of the more variable winters show up  
10 in -- in this experience. But, largely, it'll be  
11 consistent with the -- with our cover or claim  
12 projections for collision.

13                   I would describe our performance as  
14 pretty good. You can see there are -- like, take  
15 2009/'10, for example. We thought there'd be 266  
16 million and only 234 million came in. My -- my -- I  
17 believe that was a -- a very favourable winter.

18                   You move over to '12/'13. We were  
19 thinking it was 295 million, and then we had a -- a  
20 poor winter, as we've described in the overview, and  
21 all of a sudden it's 318 million. So winter is the  
22 main driver; frequency is very, very stable in the  
23 summer. So that's -- that's what you're seeing there.

24                   Comprehensive coverage, again, should  
25 echo the -- the cover -- or the -- the frequency

1 comparison. We're showing slightly more favourable  
2 than that which, again, was better than expected  
3 results on theft-related perils.

4           Also, I -- I should have mentioned this  
5 on the frequency side. Comprehensive also has hail in  
6 there. So any time there's any kind of substantial  
7 hail, there's going to be a deviation. Or if we have  
8 no hail there's going to be a deviation. So that's  
9 another -- another piece there.

10           Property damage again will be similar  
11 to collision, fairly -- I think a good forecast  
12 performance there. And public liability, ver -- a  
13 very variable coverage, so -- but -- but small  
14 dollars.

15           MS. CANDACE GRAMMOND: So is it fair  
16 to say then for the PIPP coverage that the cause of  
17 any major deviations have been adjustments,  
18 specifically reserve adjustments?

19           MR. LUKE JOHNSTON: Can you repeat  
20 that question, please.

21           MS. CANDACE GRAMMOND: Sure. Would it  
22 be fair to say -- and I'm just talking about the PIPP  
23 coverage line -- that the -- a major driver of  
24 deviations from forecast to actual have been reserve  
25 adjustments? And an example would be in the 2010

1 year.

2 MR. LUKE JOHNSTON: Yes, in that year,  
3 def -- definitely. There -- there were -- I don't  
4 have them in front of me, but there were definitely  
5 reserve -- liability review reserve adjustments,  
6 specifically releases, prior to 2010/'11, as well.  
7 And there's al -- there's always going to be some  
8 variability in the policy liability review.

9 Ten (10) basis point change is -- is  
10 about 16, \$17 million, just to give you an example of  
11 the sensitivity in the liability review. So there's  
12 going to be ups and downs there. But the -- the  
13 expectation is that we're at a best estimate now. And  
14 hopefully those -- those deviations should be minor on  
15 a relative basis hopefully in the 20, 30 million, plus  
16 or minus range.

17 MS. CANDACE GRAMMOND: And can you  
18 comment on how the numbers that we see here are  
19 affected by benefit enhancements?

20

21 (BRIEF PAUSE)

22

23 MR. LUKE JOHNSTON: I would like to  
24 check to -- with my back row and maybe at the break to  
25 make sure that the benefit enhancements were in the

1 original and projected forecast just to make sure that  
2 if -- if they were in there, in -- you know, because  
3 when they came out in 2010, I believe, it -- it might  
4 not have been known at the time of the original  
5 forecast that those were coming. So I'll check that.

6 But in general, the enhancements would  
7 be in the forecast. To date, our PIPP enhancement  
8 projections have come out more favourably than  
9 expected, so that would be a source of a favourable  
10 deviation.

11

12 (BRIEF PAUSE)

13

14 MS. CANDACE GRAMMOND: So if, in any  
15 given year, benefit enhancements were not known about  
16 at the time of the original projection but kicked in  
17 prior to the actual number becoming crystalized, there  
18 would have been an effect on the actual number?

19 MR. LUKE JOHNSTON: Yeah. And that's  
20 what I wanted to -- to make sure, just that -- that  
21 it's not really apples to apples if one (1) forecast  
22 doesn't have those enhancements in there, and then you  
23 add them. So I just wanted to make sure that -- that  
24 that was the -- that they were part of the forecast.

25 MS. CANDACE GRAMMOND: Thank you.

1 Now, is there any evidence on an overall basis with  
2 all covers of systemic bias in claims forecasting?

3 MR. LUKE JOHNSTON: There was  
4 obviously some issues with PIPP that we had to rectify  
5 in two -- in 2010/'11. And we -- we had long  
6 discussions on that. And -- and a lot of it had to do  
7 with just understanding the -- the PIPP experience.  
8 After our new reserving guidelines were put in in  
9 2005, we got five (5) years of experience. And -- and  
10 in 2010, we made a full adjustment to reflect those  
11 indications.

12 So on that -- on that front, there was  
13 a adjustment we made -- we made at that time. We  
14 believe we're at best estimate now. All coverages out  
15 -- outside of PIPP are and continue to be best  
16 estimates.

17 MS. CANDACE GRAMMOND: Thank you. I'm  
18 going to move then to a different area dealing with  
19 the new financial forecasting model. So, Mr.  
20 Johnston, we understand that the Corporation has  
21 implemented a new financial forecasting model this  
22 year.

23 Is that right?

24 MS. HEATHER REICHERT: Yes, that's  
25 correct.



1 MS. CANDACE GRAMMOND: Okay. Ms.  
2 Reichert, thank you. And as reflected in the filing,  
3 the new model can more accurately incorporate complex  
4 assumptions regarding various types of investments  
5 held.

6 Is that right?

7 MS. HEATHER REICHERT: Yes.

8 MS. CANDACE GRAMMOND: And, as well,  
9 the Corporation now has the ability to forecast  
10 rebalancing of the investment portfolio pursuant to  
11 the investment policy statement.

12 MS. HEATHER REICHERT: Yes, that's  
13 correct.

14 MS. CANDACE GRAMMOND: And as well,  
15 the Corporation has the ability to forecast interest  
16 rate changes on the value of the fixed income  
17 investments, as well as claims liabilities.

18 MS. HEATHER REICHERT: Yes, that is  
19 correct.

20 MS. CANDACE GRAMMOND: Whereas under  
21 the old system, modelling of interest rate changes was  
22 not possible.

23 MS. HEATHER REICHERT: Correct.

24 MS. CANDACE GRAMMOND: Now, we  
25 understand that the new financial model was developed

1 by a consultant under the supervision of the corporate  
2 controller, the chief actuary Mr. Johnston, the acting  
3 investment manager, and their respective teams.

4 Is that right?

5 MS. HEATHER REICHERT: Yes, that is  
6 correct.

7 MS. CANDACE GRAMMOND: And the  
8 Corporation has also advised us that the model is  
9 still a work in progress.

10 MS. HEATHER REICHERT: It -- it's a  
11 work in progress from the standpoint that we are  
12 intending on incorporating a balance sheet into the  
13 financial model.

14 MS. CANDACE GRAMMOND: And that that  
15 is -- balance sheet inclusion is expected to be  
16 provided to this Board next year.

17 MS. HEATHER REICHERT: That is -- that  
18 is the plan at this point.

19 MS. CANDACE GRAMMOND: Now, the Board  
20 had asked about sharing the model in order that it  
21 could be reviewed by the Board and -- and its  
22 advisors. And the Corporation had advised that the  
23 model is very complex to use and for that reason could  
24 not be shared.

25 Can you comment on that?

1 MS. HEATHER REICHERT: Yes, I can. I  
2 -- and I think the -- the best response might be to  
3 read in how we responded in one of the -- the  
4 Information Requests:  
5 "The Corporation uses various models  
6 to support our overall rate  
7 indication. They are large and  
8 complex, the ones the actuaries use  
9 as well as the ones that we use for  
10 financial modelling. The  
11 Corporation expects that an  
12 independent -- independent analyst  
13 that is untrained with the  
14 Corporation's model would need to  
15 invest a significant amount of time  
16 and effort to be capable of  
17 operating the model correctly.  
18 Allowing other parties to work in  
19 and modify spreadsheets and pose  
20 questions and Information Requests  
21 and on cross-examination based on  
22 the modified schedules will also  
23 require the Corporation to invest a  
24 significant amount of time analyzing  
25 the changes made to the spreadsheets

1 and to understanding their potential  
2 impacts.  
3 This approach, in our opinion, is  
4 inefficient. It would require  
5 addition time to be provided within  
6 the regulatory process, and would  
7 make the regulatory process more  
8 cumbersome. The Corporation has not  
9 provided the full versions or the  
10 underlying Excel files with formulas  
11 of these models to the Public  
12 Utilities Board and Intervenors in  
13 past general rate applications. The  
14 Corporation has provided very  
15 detailed support for all the models,  
16 including the investment income  
17 model, as part of the GRA, part of  
18 the interrogatory, and rehearing  
19 processes."

20 And I did hand out -- or we handed out  
21 as an exhibit at -- on the first day, I believe, a  
22 summary of just a snapshot of all of the various  
23 scenarios that were run by the Corporation in response  
24 to requests made by both the Public Utility Board and  
25 the Consumers' Association where we assumed different

1 assumptions with respect to interest rates, or  
2 volumes, or upgrades, or -- or whatever was -- was  
3 requested.

4 And so I do believe that we have  
5 provided sufficient information for -- for the Public  
6 Utility Board to be able to have comfort that we are  
7 being transparent in the financial model.

8 MS. CANDACE GRAMMOND: Ms. Reichert,  
9 can you indicate for the record what IR you were  
10 reading from?

11 MS. HEATHER REICHERT: I'm sorry. I'm  
12 reading from IR PUB-2-14.

13 MS. CANDACE GRAMMOND: Thank you.  
14 Now, I believe in that same IR response the  
15 Corporation stated that while there was extensive  
16 testing of the new model, there is no formal  
17 documentation of that testing that can be provided.  
18 Can you comment on that?

19 MS. HEATHER REICHERT: It is just a  
20 matter of -- of timing. We -- we are continuing to  
21 work with our consultant on the financial model, as I  
22 indicated, to incorporate the balance sheet. And when  
23 we have that aspect incorporated, we will receive full  
24 documentation of the testing that has been done on the  
25 entire model. So really, it was just the matter of

1 timing, getting all of that documentation in place in  
2 time for this -- for this hearing.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: If the  
7 inclusion of the balance sheet and the rest of the  
8 testing is still in process, why did the Corporation  
9 elect to come forward with the model for this year's  
10 GRA as opposed to waiting until next year?

11 MS. HEATHER REICHERT: The -- the  
12 financial model, as it's been enhanced this year,  
13 provided the Corporation with -- with the ability to  
14 do a lot more modelling, a lot more complex modelling.  
15 Ideally, it would have been nice to have been able to  
16 have the balance sheet ready this year as well. That  
17 wasn't possible, but that did not negate the fact that  
18 we had the bulk of the income statement modelling from  
19 the financial model to be able to use it and improve  
20 our internal processes with respect to the -- the  
21 financial model.

22 So we opted to -- to use the aspect of  
23 the financial model that we did have and we will add  
24 to that by incorporating the balance sheet in next  
25 year's -- next year's model.

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: Thank you.

4 Now, I understand that -- back to the issue of  
5 investment rebalancing -- the new forecasting model  
6 assumes a rebalancing between the current investment  
7 targets for each investment class?

8 MS. HEATHER REICHERT: Yes, that is  
9 correct.

10 MS. CANDACE GRAMMOND: And I -- and as  
11 I believe we discussed last week, it's the Investment  
12 Committee Working Group that has the responsibility to  
13 rebalance the portfolio from time to time?

14 MS. HEATHER REICHERT: Yes. The  
15 Investment Community Working Group monitors the  
16 allocation -- or the actual allocation of each aspect  
17 of the investment portfolio. But when you are  
18 creating a financial model, you have to make some  
19 assumptions with respect to at what point reasonably  
20 you would move to rebalancing the portfolio.  
21 Otherwise, the other option would be to assume no  
22 rebalancing ever occurs. And we didn't want to build a  
23 model that assumes something such as that.

24 So we had to build within the model  
25 assumptions at what point would rebalancing occur.

1 And that is documented for the Board's behalf in the  
2 actual investment section of our Application. And I'm  
3 just -- I know that...

4

5 (BRIEF PAUSE)

6

7 MS. HEATHER REICHERT: I -- I'm not  
8 sure if the Board wants to -- to go into what's  
9 underlying the investment model with respect to the  
10 rebalancing. I can definitely go through that if --  
11 if that's desired. But it's clearly articulated  
12 within our investment section, the assumptions that we  
13 are making in the model about rebalancing.

14 MS. CANDACE GRAMMOND: Thank you.

15 MR. REGIS GOSSELIN: Could you give us  
16 a reference, please?

17 MS. HEATHER REICHERT: It is page 39  
18 of the investment section of the GRA.

19

20 CONTINUED BY MS. CANDACE GRAMMOND:

21 MS. CANDACE GRAMMOND: Thank you, Ms.  
22 Reichert. So let me ask you this: To the extent that  
23 at a given per -- or point in time, the amount held  
24 within a particular investment class may be different  
25 than the range that's provided in the re-balancing



1 policy -- and that does happen from time to time for  
2 different reasons -- would there not be, then, the  
3 potential for a departure from what the model  
4 reflects, or what the model -- what the model would  
5 reflect?

6 MS. HEATHER REICHERT: I think I need  
7 to ask you to repeat the question.

8 MS. CANDACE GRAMMOND: Sure. I can  
9 maybe rephrase it. So if the model -- if the new  
10 model assumes a re-balancing of the portfolio by  
11 investment class within the targets provided in the  
12 IPS, investment policy statement, what I'm asking is,  
13 from time to time, for whatever reason a given class  
14 may be outside of that target range. There may be  
15 more within a certain class or less.

16 How does that affect the financial  
17 model? Maybe that's the better way to ask the  
18 question.

19 MS. HEATHER REICHERT: So the  
20 financial model that we have -- have built, with its  
21 underlying assumptions, is doing a best estimate  
22 given the -- the assumptions that are un -- underlying  
23 it. So to the extent that we are modelling for re-  
24 balancing to occur based on -- on criteria built  
25 within the model, to the extent that that doesn't

1 happen in real life, there will be differences from --  
2 between your forecast and what actually occurs.

3           But the model is built such to be able  
4 to make as good a forecast as possible, considering  
5 the movements of -- within investment categories, et  
6 cetera. So I -- I'm not sure if that -- that -- if  
7 that answers, you know, completely the question that's  
8 being asked, but a forecasting model is just that.  
9 It's forecasting. And to the extent that it mirrors  
10 what actually happens a year or two (2), three (3)  
11 years down the road, that is something that is  
12 revisited each year that we go to forecast for -- for  
13 the -- for the next year.

14           MS. CANDACE GRAMMOND: Okay. So if I  
15 understand your answer correctly, then, within the  
16 framework of the model, and the com -- the assumption  
17 within the model, that investment classes will be  
18 within a specific range.

19           If any investment class deviates from  
20 that range for whatever reason then the -- the  
21 ultimate forecast will just be a little bit less  
22 accurate than it otherwise would have been?

23           MS. HEATHER REICHERT: Yes, as with  
24 any forecast: any forecast for claims, for investment  
25 income.

1                   Sorry, maybe I'm misunderstanding  
2 exactly what you're asking. Are you asking whether or  
3 not, built within the model itself, is an automatic  
4 re-balancing? Like, underlying the -- the model  
5 assumptions that it will automatically re-balance if,  
6 within the model, we get to a point where we are  
7 outside of a particular target range?

8                   MS. CANDACE GRAMMOND: Sure. Why  
9 don't you tell me the answer to that.

10                  MS. HEATHER REICHERT: Okay. So,  
11 again, I will refer the Board to page 39 of the  
12 investment income section where it does specifically  
13 indicate how the model is built and how it will  
14 automatically adjust if we are outside of a particular  
15 range based on the -- the assumptions here. I'll  
16 take, as an example, on page 40. At the top of page  
17 40, I'll -- I'll just read this in to help the Board  
18 not have to -- to look -- look at the actual page. So  
19 for marketable bonds:

20                         "For Canadian fixed income, when  
21                                 marketable bonds remain outside the  
22                                 tolerance range as defined in -- in  
23                                 Table 10.1  
24                                 ranges that we hold our -- our  
25                                 market bon -- bonds at] for two (2)

1 consecutive quarters, the asset  
2 class will be adjusted to the target  
3 weight in the following quarter.

4 [So] The total portfolio  
5 reallocation requirements will be  
6 sourced from or reallocated in the  
7 following proportions: to Canadian  
8 equities, 75 percent, and US  
9 equities, 25 percent."

10 So what that is saying is that within  
11 the model, as -- as we are modelling to -- to receive  
12 more income from premiums, and so the amount of cash  
13 that we are holding increases -- or, pardon me, the  
14 amount of marketable bonds that we are holding  
15 increases.

16 If within the model it increases beyond  
17 the -- the targeted ranges that we have, the model  
18 will then re-balance. It will get it back to the  
19 range that it needs to be within, and it will do that  
20 by saying, Okay, if we have to remove 10 million of  
21 marketable bonds from a particular quarter, it will  
22 re-balance it by saying, Okay, 10 million, we're going  
23 to purchase 75 percent of that 10 million, so  
24 whatever, seven million five hundred thousand  
25 (7,500,000) worth of Canadian equities and two million

1 five hundred thousand (2,500,000) worth of US  
2 equities.

3 So it's all very clearly laid out what  
4 is underlying the model as it relates to each of the  
5 investment categories.

6 MR. REGIS GOSSELIN: I -- I guess the  
7 follow-up question is: What happens to that  
8 percentage that you've dropped? Say, for example,  
9 you're at seventy-seven (77) and your model says,  
10 Well, we'll use seventy-five (75) for calculation  
11 purposes.

12 Where the -- where does the 2 percent  
13 go?

14

15 (BRIEF PAUSE)

16

17 MR. REGIS GOSSELIN: I'm sorry, do you  
18 put in equities or...?

19 MS. HEATHER REICHERT: Well, exactly.  
20 That -- that's -- for instance, if marketable bonds is  
21 overweight, right, so we have to remove money from  
22 marketable bonds, built within the model is that first  
23 75 percent would go to Canadian equities, so we assume  
24 we purchased more Canadian equities, a 75 percent  
25 ratio and US equities at a 25 percent ratio.

1 MS. CANDACE GRAMMOND: Thank you.

2 Madam chair, I just have a couple more questions on  
3 this. But I'm happy to take the morning break and  
4 deal with those when we come back.

5 THE CHAIRPERSON: I think it would be  
6 timely to take a break for fifteen (15) minutes and  
7 come back around a little shortly after 11:00.

8

9 --- Upon recessing at 10:46 a.m.

10 --- Upon resuming at 11:03 a.m.

11

12 THE CHAIRPERSON: I think we're ready  
13 to start again. So, Ms. Grammond, I -- you shrunk.

14 MS. CANDACE GRAMMOND: I'm trying a  
15 different chair. We'll see if that makes a  
16 difference.

17 THE CHAIRPERSON: Okay. Thank you  
18 very much.

19 MS. CANDACE GRAMMOND: If not, I have  
20 a -- I have a little cushion for under my knees now,  
21 so we'll put that down.

22

23 CONTINUED BY MS. CANDACE GRAMMOND:

24 MS. CANDACE GRAMMOND: Okay. So I'm  
25 actually going to leave the area regarding re-

1 balancing. I'm going to go into a different area  
2 dealing with forecasting, and that is with respect to  
3 the linear, exponential, and financial forecasts that  
4 we have dealt with at the Board in the past.

5                   So, Mr. Johnston, we understand that  
6 the Corporation initially within this filing didn't  
7 provide the linear and exponential trending numbers  
8 for comparative purposes.

9                   Can you comment on the reasons for  
10 that?

11                   MR. LUKE JOHNSTON: Yes, yes, I can.  
12 The -- there was an over -- there was an oversight on  
13 my part of not recognizing that there was actually a  
14 Board order from -- from many years ago. I didn't  
15 realize that. The -- in -- in preparing the new  
16 format of the rate application, the question that we  
17 asked was: What is the value from the -- these linear  
18 and exponential forecasts.

19                   And I talked about this in -- in  
20 direct. The -- we didn't see a benefit of -- of -- to  
21 the Board of using a purely linear projection to -- to  
22 produce a rate indication or an exponential projection  
23 to produce a rate indication. Our preference would be  
24 that the Board consider the information in the claims  
25 incurred section of the Rate Application.

1                   And the Corporation, of course, would  
2 be more than willing to -- to produce alternate rate  
3 indications based on -- on the information in that  
4 section. So if -- if there's a sense that the Board  
5 would like to see a different view on the collision  
6 forecast or -- or the PIPP forecast, we feel that  
7 would be more meaningful to provide those scenarios  
8 than it would to just fit a line through the history  
9 of the Corporation's experience.

10                   MS. CANDACE GRAMMOND: Thank you.  
11 Now, in response to an IR that the Board posed, and in  
12 particular it's 1-37. It's found at Tab 15 of the  
13 Board's book of documents. So you may wish to go  
14 there. You don't necessarily have to. If -- if the  
15 panel's going to go there, Tab 15, PUB/MPI-1-37.

16

17                   (BRIEF PAUSE)

18

19                   MS. CANDACE GRAMMOND: Tab 15, Board's  
20 book of documents, PUB/MPI-1-37. So within that  
21 response, at the top of page 2, the Corporation has  
22 indicated that:

23                   "The financial forecast involves a  
24 more thorough analysis of each  
25 forecast variable than the linear



1 and exponential methods."

2 Is it fair to say that the  
3 Corporation's approach to preparing those linear and  
4 exponential forecasts is relatively mechanical and not  
5 very analytical?

6 MR. LUKE JOHNSTON: Yeah, that's fair.

7 MS. CANDACE GRAMMOND: Can you comment  
8 on how significant the necessary effort is to prepare  
9 those other two (2) forecasts, the linear and  
10 exponential, as has been done by -- in the past?

11 MR. LUKE JOHNSTON: The calculation  
12 exercise is fairly straightforward. The -- there's --  
13 there is obviously administrative work required to  
14 prepare the exhibits. It also requires a new  
15 financial model to be run, and any supporting rate-  
16 making information. So it's not, by -- I wouldn't --  
17 I wouldn't describe it as difficult. But I would  
18 describe it as not adding a -- a lot of value to the  
19 Board.

20 MS. CANDACE GRAMMOND: Now, if in the  
21 past the Board, the PUB, has considered the linear and  
22 exponential forecasts as benchmarks to prove or to  
23 assess the reasonableness of the financial forecast,  
24 is the Corporation recommending against this practice  
25 going forward?

1 MR. LUKE JOHNSTON: Yes, for the --  
2 for the reasons discussed, not on this IR, but there  
3 are definitely cases where using a linear or  
4 exponential trend is not appropriate for a certain  
5 coverage, so we don't -- we don't recommend using them  
6 as benchmarks. Per my previous statements, we'd much  
7 prefer the Board look at the claims incurred section.  
8 And if they -- if they would like alternative  
9 scenarios we can run them based on recommendations  
10 from the -- that analysis.

11 MS. CANDACE GRAMMOND: I would ask you  
12 to go then to Tab 27 of the book of documents, which  
13 is PUB/MPI-2-17, dealing with the same issue. And  
14 this is an excerpt, for the record, of this IR. It  
15 was quite lengthy, so this isn't the -- the full IR.  
16 Looking at the table on page 2 under the answer to  
17 (b). So Board book of documents, Tab 27, page 2.

18 Can you confirm, looking at the table,  
19 that the overall indicated rate change as applied for  
20 of 1.8 percent compares to 3.6 percent increase under  
21 the linear method, and a 4.4 percent increase under  
22 the exponential method?

23 MR. LUKE JOHNSTON: Confirmed.

24 MS. CANDACE GRAMMOND: Now, it seems  
25 as though the divergence between the financial

1 forecast on the one hand and the linear and  
2 exponential forecast on the other has grown this year.

3                   Would you agree?

4                   MR. LUKE JOHNSTON: Yeah, in a -- in a  
5 general sense. And my recollection is that often the  
6 financial forecast may fall in between the two (2)  
7 methods, for example. There are -- there's been other  
8 years where it's -- it's been different. But this  
9 would be a fair significant difference on a -- from  
10 historical calculations that we've done.

11                   MS. CANDACE GRAMMOND: And can you  
12 comment on the primary drivers for that change?

13

14   (BRIEF PAUSE)

15

16                   MR. LUKE JOHNSTON: One -- one area  
17 for sure that is -- is change -- I would say is  
18 changing relative to historical trends would be PIPP.  
19 There -- we've seen basically flat, and -- and in some  
20 cases negative, growth rate on the -- on the PIPP  
21 coverages. So that -- that would be one piece where I  
22 -- I would expect our financial forecast likely  
23 produces a lower estimate than -- than a linear or an  
24 exponential trend.

25                   The other one would probably be

1 comprehensive again. We're -- for a lot of the  
2 coverages in -- in the comprehensive line, we're  
3 either flat -- basically assuming flat growth. So,  
4 you know, we've got a certain number of vandalisms and  
5 they haven't changed at all relative to -- to fleet  
6 growth, so our forecast assumes it's going to stay  
7 that way.

8                   So that -- those would be a couple  
9 cases where we -- we'd project something lower than --  
10 than linear or exponential.

11                   MS. CANDACE GRAMMOND: Thank you.  
12 Now, the information at 2-17 that we've been looking  
13 at, and in terms of the different indicated rate  
14 changes for the different methods, can you confirm  
15 that subject to the experience-based adjustment rules,  
16 there have been no changes to the rate-making rules  
17 that impact -- or that limit, rather, the maximum  
18 adjustment of 15 percent?

19                   MR. LUKE JOHNSTON: Yes. No changes  
20 to our experience adjustment rules.

21                   MS. CANDACE GRAMMOND: So that  
22 experience-based adjustment is still between a  
23 negative 15 percent and a plus 15 percent?

24                   MR. LUKE JOHNSTON: Correct.

25                   MS. CANDACE GRAMMOND: Which makes it

1 revenue neutral?

2

3

(BRIEF PAUSE)

4

5

MR. LUKE JOHNSTON: Sorry, yes.

6

MS. CANDACE GRAMMOND: Now, going back  
7 to the indicated rate changes under the exponential  
8 and linear methods, can you comment on the  
9 Corporation's comfort level with the applied for 1.8  
10 percent increase and whether that is sufficient, given  
11 the higher rate increases referenced under the other  
12 models?

13

MR. LUKE JOHNSTON: Actu -- actually,  
14 I -- I can comment that it's sufficient, and without  
15 even looking at the other models. The -- all the  
16 support for the 1.8 percent is basically the -- the  
17 Rate Application.

18

The -- if you want to know why -- why  
19 the claims are appropriate, you -- you can go to the  
20 claims incurred section and there's a lot of detail  
21 there. Similar with investment income.

22

I -- I think the question is  
23 essentially asking me to benchmark against those --  
24 those forecasts, and I'm -- I'm suggesting that I  
25 don't think that's appropriate to do so -- do -- to do

1 so.

2 MS. CANDACE GRAMMOND: So the  
3 Corporation, and I -- I think you referred to this  
4 earlier, Mr. Johnston, does recognize that pursuant to  
5 the now somewhat old Board order, the Board, until it  
6 decides otherwise -- or unless and until it decides  
7 otherwise, does still require these other forecasts in  
8 order that it can assess reasonableness?

9 MR. LUKE JOHNSTON: Absolutely. And  
10 we'll -- we'll continue to provide them if the Board  
11 sees that they would like to still have them.

12 MS. CANDACE GRAMMOND: Thank you. I'm  
13 going to move then into some questions dealing with  
14 stochastic modelling. So I do have a document from  
15 the filing that I've brought for distribution, just  
16 for ease of reference. So I'll maybe circulate that.

17

18 (BRIEF PAUSE)

19

20 MS. CANDACE GRAMMOND: So we're going  
21 to start with the second and third pages. The first  
22 page that's here I will be referring to a little bit  
23 later on. It just happened to be the top page.

24 So we see -- and -- and for the  
25 purposes of the record we can mark this as an exhibit,

1 but we don't necessarily need to, because it is just  
2 excerpts of the existing filing. I don't know if Ms.  
3 Kalinowsky has a preference?

4 MS. KATHY KALINOWSKY: Sure.

5 MS. CANDACE GRAMMOND: Okay. Yeah, so  
6 I'm happy to have it marked. This would be PUB  
7 Exhibit.... Maybe the Board secretary can just  
8 advise. What number are we at?

9

10 (BRIEF PAUSE)

11

12 MS. CANDACE GRAMMOND: Perfect. So  
13 this is PUB Exhibit 12, then, these three (3) pages  
14 from the filing.

15

16 --- EXHIBIT NO. PUB-12: Three (3) pages from  
17 filing

18

19 CONTINUED BY MS. CANDACE GRAMMOND:

20 MS. CANDACE GRAMMOND: So if we turn  
21 then to the second page here, we see an excerpt from  
22 RSR-2, the 2013 DCAT report filed in this proceeding.  
23 And I'm -- I'm going to come to that in a moment.

24 But, Mr. Johnston, first of all perhaps  
25 you could, just to refresh all of our memories, remind

1 us about what stochastic modelling is and how it has  
2 been applied in the GRA before the Board?

3

4 (BRIEF PAUSE)

5

6 MR. LUKE JOHNSTON: So the stochastic  
7 modelling here is -- is claims only. And all we're  
8 doing, really, is looking at the probability  
9 distribution around each indiv -- individual claims  
10 forecast as opposed to just forecasting a single point  
11 estimate. And all -- as you know, MPI has large  
12 amounts of claims data which allows us to create  
13 fairly credible statistical models to simulate the --  
14 the expected distribution of -- of results around our  
15 ex -- expected value, our -- our best estimate value  
16 that we put in the Rate Application.

17 MS. CANDACE GRAMMOND: Thank you. And  
18 at a high level, Mr. Johnston, can you describe the  
19 considerations necessary to combine the results of the  
20 stochastic modelling done at the coverage level to  
21 produce results for all coverages combined?

22

23 (BRIEF PAUSE)

24

25 MR. LUKE JOHNSTON: So at -- at the --



1 kind of the fundamental level for claim costs to  
2 happen, there has to be an accident. And so a -- a  
3 col -- a collision or -- would be an example, not for  
4 comprehensive, but for just being accidents. So first  
5 what we do is we -- we simulate the number of  
6 collisions we're expecting to have. And again,  
7 there's -- there's very credible history on that. The  
8 Corporation has a hundred-thousand-plus collision  
9 claims a year and decades of -- of history to -- to  
10 view.

11                   From that we have to -- we simulate  
12 whether -- the severity of the collision and whether  
13 that collision involves injuries. From that there's  
14 also a range of injuries that can occur on -- on a  
15 particular collision. The -- similarly, there's --  
16 there's property damage. There's a likelihood that  
17 property damage will occur on a collision.

18                   All these -- it's kind of hard to  
19 describe in words, but all these factors are  
20 essentially modelled based on experience. There's  
21 correlations, relationships between, you know, how  
22 these coverages interact with each other. And that's  
23 run through a statistical program that we have called  
24 At Risk. And that's just an Excel-based statistical  
25 program.

1                   And then the -- outside of that,  
2 there's -- there's comprehensive coverage which we  
3 assume independent -- is independent of -- of  
4 collisions, and we model that one comple -- completely  
5 separately. Comprehensive also includes hail, which  
6 is -- we have another model for -- for hail, as well.

7                   So, yeah, long story short, there's  
8 some cases where coverages are very correlated with  
9 each other and we have to consider those aspects and  
10 other cases that we -- like -- like hail, for example,  
11 that we model independently.

12                   MS. CANDACE GRAMMOND: Thank you.  
13 Now, with reference here to the excerpt at -- or of  
14 RSR-2 from the filing, we see on page 87 the heading  
15 "Overall results," and then two (2) tables that follow  
16 reflecting, first, the base forecast and, second,  
17 cumulative simulated ultimate losses for all Basic  
18 coverages.

19                   I'm going to ask you to actually turn  
20 over the page to page 88. And we'll see the top table  
21 there is entitled:

22                   "Cumulative simulated ultimate  
23 losses minus base forecast for all  
24 Basic coverages."

25                   And we've got a range of years, from

1 the current year through the outlook period and  
2 2017/'18.

3 Can you describe the GRA forecast for  
4 basic claims incurred as it relates to these  
5 particular stochastic modelling results?

6 MR. LUKE JOHNSTON: On -- just -- just  
7 turning back the page for -- for a moment. There's --  
8 on -- on page 87 there's a table at the top, and it  
9 says "Annual and cumulative." So annual is the -- the  
10 cost actually associated with that accident year that  
11 we've simulated. And then going forward, those are  
12 the -- the annual impacts.

13 Cumulative is simply the sum of each  
14 year, you know, cumulatively increasing. And the --  
15 the reason we do that is because there's -- there's a  
16 forecast made today and there's a risk, you know, time  
17 -- as time passes that it'll deviate from our base,  
18 and it -- it compounds. It definitely does like a --  
19 we're going to come back next year and have a new  
20 forecast, obviously. But for -- for this base  
21 forecast right now, there is a potential for it to  
22 deviate from the -- from the base.

23 So when you turn to page 88, what the  
24 table on the -- on the top is saying is, How much can  
25 we deviate on a cumulative basis from our base

1 forecast as each -- as time passes -- as each year  
2 passes.

3                   So on -- in the 2013/'14 year we're  
4 saying that in 95 percent of the time we'd expect our  
5 -- our claims results to be within a \$35 million  
6 favourable variance to -- to about a \$50 million or  
7 \$48 million variance from -- from the base.

8                   As time passes, obviously there's  
9 potential that that -- that one (1) year's over budget  
10 can compound on a previous year's over -- over budget  
11 result, and the -- the numbers start getting bigger.

12                   But you'll -- you'll notice that --  
13 take the 97.5th percentile, which was again the -- the  
14 simulated outcome that's bigger than 97.5 percent of -  
15 - of our -- of our scenarios. You'll notice that it -  
16 - it's not -- the first year is a \$48 million impact  
17 but the year after isn't forty-eight (48) times two  
18 (2), right.

19                   There's the odds of two (2) really,  
20 really bad years occurring right after each other  
21 would not qualify as a -- you know, the same  
22 percentile. So the -- the impacts obviously grow but  
23 on an incremental basis they get smaller as we assume  
24 to a large extent that the years are complete --  
25 completely independent of each other.

1 MS. CANDACE GRAMMOND: Thank you. Mr.  
2 Johnston, would you agree with respect to this table  
3 that the cumulative Basic claims incurred follows very  
4 closely to the median forecast from the stochastic  
5 modelling? And I'm -- I understand that it's within  
6 about \$3 million after five (5) years.

7 MR. LUKE JOHNSTON: Just -- just to be  
8 clear, I believe the question is that the 50th  
9 percentile, or the -- the median simulation is very  
10 close to the base forecast, and I would confirm that's  
11 correct.

12 MS. CANDACE GRAMMOND: And when we use  
13 the term 'median' you would agree that means equally  
14 likely to be high or low?

15 MR. LUKE JOHNSTON: Correct.

16 MS. CANDACE GRAMMOND: Thank you. Mr.  
17 Johnston, can you elaborate on any areas of expected  
18 improvement going forward as the stochastic modelling  
19 process continues to evolve for future applications?

20

21 (BRIEF PAUSE)

22

23 MR. LUKE JOHNSTON: I'm thinking  
24 there's an IR on this but I can -- I can speak to it  
25 from memory. We're always -- like any component of

1 the DCAT or stochastic model, we -- we're always  
2 looking for -- for ways to improve that model.

3 A couple things that we're looking at  
4 in the future will be considering some of the -- the  
5 driver safety rating input into the model, other  
6 things that -- like inflation, interest rates, things  
7 like that that are more difficult to model on a  
8 stochastic basis, so including the discounting and all  
9 -- and all of those aspects.

10 We're also looking at the relationship  
11 between -- better understanding the relationship  
12 between what type of collisions result in particular  
13 types of -- of injuries. So right now we -- we say,  
14 you know, if a collision happens the chance of an  
15 injury is -- is 'X'. Well, different situations can  
16 rise to very different severity collisions, so maybe  
17 modelling rural differently than Winnipeg would be an  
18 enhancement.

19 So those are a couple that -- a few  
20 that come to mind.

21 MS. CANDACE GRAMMOND: Thank you.  
22 Madam Chair, can we take a two (2) minute break, with  
23 the Board's indulgence?

24 THE CHAIRPERSON: Yes.

25 MS. CANDACE GRAMMOND: Thank you.

1 THE CHAIRPERSON: Yes.

2

3 (BRIEF PAUSE)

4

5 MS. CANDACE GRAMMOND: Thank you,  
6 Madam Chair. My apologies.

7

8 CONTINUED BY MS. CANDACE GRAMMOND:

9 MS. CANDACE GRAMMOND: Mr. Johnston,  
10 I'm going to move then into some questions dealing  
11 with claims incurred and the runoff that the  
12 Corporation has experienced. I'll ask you to go to  
13 Tab 22 of the Board's book of documents. So, again,  
14 that's Tab 22. And keep -- keep that open. That is  
15 PUB/MPI-2-1. I'm also going to ask you to go to  
16 PUB/MPI-1-38.

17

18 (BRIEF PAUSE)

19

20 MS. CANDACE GRAMMOND: And what I'd  
21 ask you to do, Mr. Johnston, with reference to  
22 PUB/MPI-1-38, is to confirm that during the 2012/'13  
23 fiscal year, Basic experienced overall unfavourable or  
24 adverse runoff of prior year claims totalling about  
25 28.9 million.

1 (BRIEF PAUSE)

2

3 MR. LUKE JOHNSTON: Confirmed.

4 MS. CANDACE GRAMMOND: Thank you. Can  
5 you comment on how many years it has been since the  
6 last time that Basic experienced overall unfavourable  
7 runoff of prior year claims?

8

9

10 (BRIEF PAUSE)

11

12 MR. LUKE JOHNSTON: It hasn't --  
13 hasn't been frequent, but I'd have to take that as an  
14 undertaking to confirm.

15 MS. CANDACE GRAMMOND: We -- we don't  
16 necessarily need an undertaking as to the specific  
17 year, but the -- the point being that it's been quite  
18 some time since there's been unfavourable runoff and  
19 that this is a bit of a change in the 2012/'13 year?

20 MR. LUKE JOHNSTON: Yes, in general,  
21 at -- at least in terms of my history here, most years  
22 have been favourable runoff up to this point.

23 MS. CANDACE GRAMMOND: Now, if we can  
24 discuss -- if we can discuss in a little bit more  
25 detail the unfavourable runoff for 2012/'13, perhaps



1 you can comment on -- or give us an overview of the  
2 sources of that unfavourable runoff?

3

4 (BRIEF PAUSE)

5

6 MR. LUKE JOHNSTON: The -- we have an  
7 explanation in PUB-1-38, Part C. I won't read it word  
8 for word. But the -- both weekly indemnity coverage,  
9 income replacement coverage, and accident benefits  
10 other index coverage, which being personal care  
11 medical benefits, both -- both of those coverages  
12 experienced higher than expected reported losses in  
13 the last year.

14 And the -- as an example, for weekly  
15 indemnity, the actual reported, include -- excluding  
16 the most recent year, was 42 million compared to 21.3  
17 million in fiscal year 2011/'12.

18 And for accident benefits other, the  
19 same numbers, 11.1 million reported in '12/'13  
20 compared to 5.6 million in the -- the year prior. So  
21 that wa -- that was the main -- the main reason for  
22 the adverse runoff.

23 MS. CANDACE GRAMMOND: Thank you. And  
24 can you tell us whether there is any aspect of that  
25 unfavourable runoff that the Corporation considers

1 particularly worrisome or alarming?

2

3

(BRIEF PAUSE)

4

5

MR. LUKE JOHNSTON: I wouldn't cla --

6

cla -- clarify it as alarming. Obviously we're not

7

pleased that our results are, particularly for weekly

8

indemnity, higher -- higher than expected. We are

9

keep -- as -- as we'll talk about from the first

10

quarter results and -- and last year's results, we are

11

keeping our eye very closely on the payment and

12

reserving patterns under the new claims management

13

system.

14

And I don't know if I need to call that

15

alarming in any way, but different. And it's -- so

16

what -- from the actuarial side, we're -- we're

17

definitely trying to understand how that system has

18

changed some of our -- our payment patterns, what we

19

need to do to properly estimate those amounts in the

20

October and February reviews.

21

MS. CANDACE GRAMMOND: Thank you.

22

Now, at the outset of this area I had asked you to go

23

to Tab 22 of the Board's book of documents and to keep

24

that open. So we'll go there now.

25

I'd ask you to confirm with respect to

1 this answer in (a) that during the first quarter of  
2 the current year, the 2013/'14 year, Basic experienced  
3 further overall unfavourable runoff of prior year  
4 claims totalling about 32.4 million. Is that right?

5

6 (BRIEF PAUSE)

7

8 MR. LUKE JOHNSTON: Sorry. And in  
9 future -- future responses I'll be sure to put a total  
10 in one (1) of my tables, so then I won't have to spend  
11 so much time looking for that. Confirmed.

12 MS. CANDACE GRAMMOND: Well, you're  
13 smart. We figured you could do the math. So, Mr.  
14 Johnston, thank you for that.

15 And can you provide an overview of the  
16 sources of this unfavourable runoff for this first  
17 quarter of current year?

18 MR. LUKE JOHNSTON: So this goes back  
19 to my direct. In the October 2012 actuarial review,  
20 we noted to -- with the external actuary and to the  
21 Board, that we were seeing changes in our -- in our  
22 payment and reserving patterns, and weekly indemnity,  
23 and AVO index.

24 Particularly it looked like paid losses  
25 were being paid either faster or -- or by a greater

1 amount while reserves were quite a bit lower than --  
2 than normal. So what we talk about when I talked  
3 earlier about this higher-of method that we use where  
4 we look at both paid and reported losses in the early  
5 years of a claim, we had a growing discrepancy there  
6 with paid looking like it was higher but case reserves  
7 looking like they were lower.

8                   So in the October review we moved to  
9 this five (5) year -- higher-of five (5) year method  
10 which gives more weight to the paid losses. So our --  
11 our thinking at the time was, You know what, maybe --  
12 maybe case reserves haven't been reported accurately  
13 or sufficiently in the -- in the new system. Let's  
14 make sure we rely on this paid data for five (5)  
15 years, and we'll base our also -- ultimates on that.

16                   So an action item from the October  
17 review was that the injury claims management division  
18 would review all their files, make sure all reserves  
19 were sufficient. They did that in March of 2013. And  
20 as a -- just get a reference here -- as noted on the  
21 bottom of -- of page 2 to PUB-2-1, it says:

22                   "The bulk of the unfavourable  
23                   runoff, 39.3 million, stems from  
24                   unfavourable runoff of 37.8 million  
25                   for accident benefits weekly

1 indemnity, and..."

2 I'll skip the next sentence, and then

3 it says:

4 "Over a two (2) week period case  
5 managers thoro -- thoroughly  
6 reviewed each claim increased  
7 reserves were applicable. We  
8 estimate that case reserves for  
9 accident benefits weekly indemnity  
10 were increased by 30 to 40 million  
11 aside from expected normal  
12 development."

13 So the -- the results from that reserve  
14 review did confirm that we had -- indeed we had issues  
15 with the posting of reserves specifically on weekly  
16 indemnity. So the issue from a financial reporting  
17 perspective is -- our normal practice with actuarial  
18 reviews is not to significantly change the assumptions  
19 from the external actuary in the quarterly reviews we  
20 do in -- in-house.

21 So you're looking at basically a full -  
22 - full, possibly even more than a full, year's worth  
23 of reserves being added in March, which obviously  
24 makes us look significantly over budget relative to  
25 one (1) -- to one (1) month. What we've seen for the

1 remainder of the year so far is very -- very little if  
2 -- and in some cases negative reserves added or -- or  
3 adjusted.

4                   So what we have to do in the October  
5 review is basically really understand what -- you  
6 know, what this means for some of the changes we've  
7 recently made, such as the higher-of method, what it  
8 means for our ultimate liabilities, and -- and we'll  
9 do that in November of this year.

10

11   (BRIEF PAUSE)

12

13                   MS. CANDACE GRAMMOND: Thank you, Mr.  
14 Johnston. And just to -- to follow on that a little  
15 bit, can you comment on how this first quarter-end  
16 valuation accounted for the accident benefits weekly  
17 indemnity case reserve review to avoid redundancy  
18 between those reserves and the estimated incurred but  
19 not reported provision?

20

21   (BRIEF PAUSE)

22

23                   MR. LUKE JOHNSTON: In -- per my  
24 previous comments, in a general sense there's -- we  
25 didn't modify any of the -- the assumptions used in

1 the previous actuarial report. For example, we didn't  
2 select new loss development factors. Because doing so  
3 -- we have our external actuar -- actuarial review.  
4 Our external actuary has agreed to those assumptions  
5 and it's our view that it would be premature to start  
6 changing those assumptions prior to -- to the review  
7 with that -- with our -- with our external actuary.

8           To the extent that experience impacts  
9 the review, that's essentially what we're doing with  
10 the quarterly reviews. We're putting the latest  
11 experience in and seeking what, you know, the re --  
12 the report would look like, you know, with -- with the  
13 latest experience. That's included in here. We  
14 haven't -- again, we haven't tried to adjust, you  
15 know, out any kind of impacts.

16           For financial reporting purposes we  
17 reviewed the budget and changed it so prior years'  
18 reported losses would be assumed to all occur in the  
19 first quarter, knowing that this is a very special  
20 circumstance. And we wouldn't expect the next three  
21 (3) quarters of reported losses to be -- or our  
22 expectation is actually that they'll be very close to  
23 zero, so we've revised the budget, but nothing -- no  
24 specific assumptions that the external actuary review  
25 were changed in the quarterly reviews.

1 (BRIEF PAUSE)

2

3 MR. LUKE JOHNSTON: Maybe -- just --  
4 just one (1) clarification. I said revised the  
5 budget. I didn't mean revise the overall PIPP budget.  
6 I just meant that we changed when that budget would  
7 have come in. So like if the overall budget was \$70  
8 million of reported for prior years, we -- we assume  
9 that that would all occur in -- in Q1 instead of  
10 evenly throughout the year.

11 So the overall budget the same, just  
12 the timing of it was changed.

13 MS. CANDACE GRAMMOND: Thank you, Mr.  
14 Johnston. What we're wondering is, isn't there a risk  
15 under the process that you've described that the  
16 amount of the IBNR, incurred but not reported, is more  
17 than it should be?

18

19 (BRIEF PAUSE)

20

21 MR. LUKE JOHNSTON: I don't -- I -- I  
22 can't really say that in -- in general. We do still  
23 have to do the review, of course. But prior years'  
24 reserves, you know, were added to years where we -- al  
25 -- also added to years where we don't have very much



1 IBNR at all. So there might be cases where we need to  
2 increase our IBNR, decrease our IBNR associated with  
3 particular accident years.

4                   There might be cases where we -- you  
5 know, we have a fairly solid estimate on -- based on  
6 paid losses, but we -- it was just a matter of getting  
7 the proper case reserves in -- in there. So it -- it  
8 really is something that needs a full review in -- in  
9 our November -- or our October 31 review. I don't  
10 want to speculate on the -- on direction on an overall  
11 basis for -- for IBNR.

12

13   (BRIEF PAUSE)

14

15                   MS. CANDACE GRAMMOND: Thank you. I'm  
16 going to move, then, to some questions dealing with  
17 the February 28, 2013, valuation and the composition  
18 of claims liabilities. So you have -- you all have  
19 PUB Exhibit 12. So we'll now be going to the first  
20 page of PUB Exhibit 12. And just for the record, this  
21 first page of Exhibit 12 is Exhibit 1, sheet 1, taken  
22 from AI-7, the actuary's report as at February 28th,  
23 2013. Yeah, and again, this is part of the filing.  
24 We just presented it as a separate exhibit so that it  
25 was easier for people to find.

1                   So, Mr. Johnston, we see here the first  
2 section within the document, numbered 1. It is  
3 entitled, "Selected IBNR," which, again, is 'incurred  
4 but not reported'.

5                   Can you comment on what that IBNR  
6 provision is?

7                   MR. LUKE JOHNSTON:    So I -- I've  
8 talked in the last twenty (20) minutes or so -- I've  
9 talked about paid. I've talked about reported and  
10 incurred losses. There's also ultimate losses, which  
11 is our estimate of the full and final value, or cost  
12 of all claims associated with a particular accident  
13 year.

14                   The difference between that -- that  
15 value that -- that we've estimated and the current  
16 reported amounts would be the -- the incurred but not  
17 reported. So there's this additional piece -- it  
18 doesn't have to be positive, it can also be negative,  
19 but -- between our current reported amounts and our  
20 ultimate value we're expecting.

21                   MS. CANDACE GRAMMOND:    So, in essence,  
22 the IBNR is for development on known claims and for  
23 the emergence of late reported claims?

24                   MR. LUKE JOHNSTON:    Yes.

25                   MS. CANDACE GRAMMOND:    Thank you.

1 Now, can you confirm that accident benefits weekly  
2 indemnity contributes the largest share of all of the  
3 lines of business? And we see that on the sixth line  
4 down under the heading, "1. Selected IBNR."

5 MR. LUKE JOHNSTON: The -- the  
6 largest share of IBNR, so the -- it's also a very  
7 significant liability as well, but in terms of IBNR  
8 it's the -- it's the largest on the -- the top table  
9 there.

10 MS. CANDACE GRAMMOND: On a net of  
11 reinsurance basis, accident benefits weekly indemnity  
12 makes up 98 million of the total of 203 million that  
13 we see reflected here?

14 MR. LUKE JOHNSTON: That's right, and  
15 the -- the large majority of that amount would be from  
16 more recent accident years where we don't have a -- a  
17 good handle on the full value of -- of the claim.  
18 There's a lot of IBNR in -- in the first one (1) to  
19 five (5) accident years.

20 MS. CANDACE GRAMMOND: Now, underneath  
21 that \$203 million total, we see an adjustment called  
22 the "Internal Loss Adjustment Expense," or ILAE  
23 provision.

24 Can you comment on what that is?

25 MR. LUKE JOHNSTON: Yeah, these are

1 claims expenses that can't be allocated specific -- to  
2 specific claims.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: Mr. Johnston, I  
7 can maybe help you out a little bit. Would it be fair  
8 to say that this adjustment represents or is -- is for  
9 the expected internal costs to settle the claims  
10 compromising the claims liabilities -- comprising,  
11 sorry.

12 MR. LUKE JOHNSTON: Yes. I was  
13 starting to ramble, I just wanted to get a -- read in  
14 a more formal definition.

15 MS. CANDACE GRAMMOND: We can be  
16 formal if you still want to read it in.

17 MR. LUKE JOHNSTON: But I -- I agree  
18 with your definition. Thanks.

19 MS. CANDACE GRAMMOND: Thank you. So  
20 we see here that this ILAE provision adds another --  
21 and I'm rounding, \$135 million to the provision, so  
22 for a total of three hundred and thirty-seven point  
23 nine (337.9)?

24 MR. LUKE JOHNSTON: Correct.

25 MS. CANDACE GRAMMOND: Now, the second

1 section of the document entitled "Number 2, CIA rules  
2 adjustment," reflects some further figures. Can you  
3 comment before we get into those what this section is  
4 for or what the CIA rules adjustments are for?

5 MR. LUKE JOHNSTON: So there's --  
6 there's two (2) pieces discussed in this section.  
7 There's a discounting assumption, so a present  
8 bringing the -- the unpaid claims to a present value  
9 basis. I won't get into our discount rate right now  
10 but this wou -- this adjustment here is essentially  
11 the effect of discounting.

12 So the -- even with fairly low interest  
13 rates right now, a lot of our liabilities are very,  
14 very long-term in nature, thirty (30) years into the  
15 future. There's a very significant impact from  
16 discounting to -- to current dollars. That also  
17 applies to the dollars we're expecting to pay for the  
18 ILAE.

19 The points 3 and 4 un -- under section  
20 2 are discu -- are the amounts for actuarial  
21 provisions for adverse deviation. So these are  
22 amounts that actuaries are required to add to their  
23 estimates. And there's a range of -- of reasonable  
24 provisions that are added for -- for claims,  
25 investments, discounting, and reinsurance.

1                   So the total impact of adding those  
2 provisions is -- or, is the numbers on the -- the two  
3 (2) lines of 3 and 4.

4

5                                   (BRIEF PAUSE)

6

7                   MS. CANDACE GRAMMOND:    So would you  
8 confirm, Mr. Johnston, that the net effect of the CIA  
9 rules on a net of reinsurance basis is to increase  
10 claims liabilities by almost 69 million?

11                   MR. LUKE JOHNSTON:    Yes.  And that's  
12 the -- that's the number, kind of the total in section  
13 2 under the "Net" column.

14                   MS. CANDACE GRAMMOND:    The sixty-eight  
15 seven one five (68,715)?

16                   MR. LUKE JOHNSTON:    Correct.

17                   MS. CANDACE GRAMMOND:    And with a  
18 reduction due to discounting to be added in of 90 --  
19 or 196 million, which are the amounts at lines 1 and 2  
20 under number 2.  And, as well, lines 3 and 4 represent  
21 a greater offset for the provision for adverse  
22 deviation of 265 million.

23                                   Is that fair to say?

24                   MR. LUKE JOHNSTON:    That's fair, yes.  
25 And in recent years, the effect of discounting has

1 gotten smaller and smaller as our interest rates have  
2 -- have declined and where -- again, where the  
3 liabilities are matched to the fixed income portfolio.  
4 But those are -- as you've described, I can confirm.

5 MS. CANDACE GRAMMOND: So the results  
6 for the IBNR and the CIA rules, which are reflected in  
7 lines 3 and 4 that you referenced, have a total net of  
8 reinsurance basis effect of 407 million.

9 Is that right?

10 MR. LUKE JOHNSTON: Sorry, can you  
11 repeat that, please.

12 MS. CANDACE GRAMMOND: Sure. So lines  
13 3 and 4, which I appreciate you referred to, so I'm  
14 excluding line 5, the net of reinsurance effect is 407  
15 million?

16 MR. LUKE JOHNSTON: Correct.

17 MS. CANDACE GRAMMOND: And, in  
18 essence, it's the sum of the 338 million under Section  
19 1 and the 60 -- almost 69 million under Section 2?

20 MR. LUKE JOHNSTON: Correct. Correct.

21

22 MS. CANDACE GRAMMOND: Thank you.

23 Now, looking at line 5 adjusted IBNR PIPP enhancement,  
24 can you comment on what gives rise to that particular  
25 adjustment for an addition of 51 million?

1 (BRIEF PAUSE)

2

3 MR. LUKE JOHNSTON: The -- as you know  
4 there's been PIPP enhancements added two (2) points in  
5 our history. I believe, 2009 and 2011. We -- being  
6 completely new coverages, we've to date segmented them  
7 from the regular liability review that we do because  
8 we're not -- we're not familiar with the patterns and  
9 the trends and everything, the development of these  
10 particular coverages.

11 So the procedure that we just went  
12 through is exactly the same for -- for PIPP  
13 enhancements. It's just segmented right now, and we -  
14 - we just put it as a separate -- a separate line.  
15 And tho -- all the PIPP enhancement information is  
16 included in appendices to the actuarial report.

17 MS. CANDACE GRAMMOND: Thank you. Mr.  
18 Johnston, you would agree that the results for total  
19 actuarial liabilities, which we see at line 6, are 458  
20 million, again on a net of reinsurance basis?

21 MR. LUKE JOHNSTON: Correct.

22 MS. CANDACE GRAMMOND: Now, we see a  
23 little bit farther down the page at line item 8, the  
24 case reserve outstanding.

25 Can you explain what gives rise --



1 sorry, line item 7. My -- my mistake. We see at line  
2 item 7 the "Case Reserve Outstanding" heading. And  
3 can you comment on what gives rise to each of the  
4 amounts for PIPP enhancement, the "other than" noting  
5 that hail catastrophe is fully reinsured?

6 MR. LUKE JOHNSTON: So I'll just  
7 confirm the question is, What gives rise to case  
8 reserves?

9 MS. CANDACE GRAMMOND: In essence,  
10 yes, broken down by the sub-line items that we see  
11 here.

12

13 (BRIEF PAUSE)

14

15 MR. LUKE JOHNSTON: Yeah. I was just  
16 asking why we still have a hundred and twenty-four  
17 thousand (124,000) of case reserves on that hail  
18 storm, but that we do. That's a diff -- so there's --  
19 compared to the -- the amounts that the case managers  
20 are putting aside, or the system is putting aside  
21 automatically, this is -- these are amounts that we  
22 still have case reserved.

23 So a case manager sets up a file, puts  
24 in all the initial estimates of the costs. We haven't  
25 paid anything yet. The whole amount is case reserves.

1 The -- as -- as the claim is paid out it draws down  
2 the reserves, and the case reserves becomes smaller.

3 So the -- again PIPP enhancements, just  
4 -- we've just segmented it from the analysis but it's  
5 the same -- the same idea. These are the current  
6 amount -- most of this is for -- for the PIPP program,  
7 but this is the current amount that our managers have  
8 set aside on their claims.

9 MS. CANDACE GRAMMOND: And the total  
10 there at -- under Section 7 is just under 967 million?

11 MR. LUKE JOHNSTON: Correct.

12 MS. CANDACE GRAMMOND: So once -- now  
13 we come to line 8, the total actuarial liabilities and  
14 the case reserve outstanding are combined. The total  
15 claims liabilities are about 1.4 billion?

16 MR. LUKE JOHNSTON: I look at that,  
17 too, and think that's a very big number, yes. Yeah,  
18 but confirmed.

19 MS. CANDACE GRAMMOND: Just wanted to  
20 make sure I didn't say it wrong because I'm not the  
21 mathematician here.

22 And that \$1.4 billion amount, Mr.  
23 Johnston, is what appears in the financial statements  
24 for Basic?

25 MR. LUKE JOHNSTON: Correct. And I'm

1 maybe jumping to the next question, carried before  
2 review are -- are -- is the amount that we actually  
3 were anticipating -- or holding at that particular  
4 point in time, which will then be adjusted to the new  
5 estimate.

6 MS. CANDACE GRAMMOND: Thank you.  
7 Madam chair, I've reached the end of this particular  
8 section, so -- and I see it's probably time for the  
9 lunch break in any event.

10 THE CHAIRPERSON: Yes, I think we'll  
11 break for lunch right now and we'll return about five  
12 (5) after 1:00. Okay. Thank you very much.

13 MS. CANDACE GRAMMOND: Thank you.

14

15 --- Upon recessing at 12:06 p.m.

16 --- Upon resuming at 1:05 p.m.

17

18 THE CHAIRPERSON: Good afternoon.  
19 We'll begin again with our hearings. And I'll call  
20 upon Ms. Grammond to continue with her cross-exam.

21 MS. CANDACE GRAMMOND: Thank you,  
22 Madam Chair. I am going to be moving into a new area.  
23 Before I do that, I think Ms. Kalinowsky has an -- an  
24 undertaking to answer on the record.

25 MS. KATHY KALINOWSKY: Not just one

1 (1) undertaking, but in the flurry of undertakings  
2 that were provided last Thursday, people were busy  
3 over the last number of days and we've got quite a  
4 small package here to provide. So I've had them  
5 circulated now. And we should mark each one of them  
6 separately as an exhibit, since they're not related to  
7 each other.

8                   So with that I'll go quickly through  
9 the record and just -- we'll mark them. The first one  
10 is Undertaking number 2, which would be MPI Exhibit  
11 number 11.

12

13 --- EXHIBIT NO. MPI-11:       Response to Undertaking  
14                                   Number 2

15

16                   MS. KATHY KALINOWSKY:   Undertaking  
17 number...

18

19                                   (BRIEF PAUSE)

20

21                   MS. KATHY KALINOWSKY:   I'll start over  
22 there. Undertaking number 2 should be marked as MPI  
23 Exhibit number 11. Undertaking number 4 should be  
24 marked as MPI Exhibit number 12.

25

1 --- EXHIBIT NO. MPI-12: Response to Undertaking  
2 number 4

3

4 MS. KATHY KALINOWSKY: Undertaking  
5 number 8 should be marked as MPI Exhibit number 13.

6

7 --- EXHIBIT NO. MPI-13: Response to Undertaking  
8 number 8

9

10 MS. KATHY KALINOWSKY: Undertaking  
11 number 11 should be MPI Exhibit number 14.

12

13 --- EXHIBIT NO. MPI-14: Response to Undertaking  
14 number 11

15

16 MS. KATHY KALINOWSKY: Undertaking  
17 number 12 should be marked as MPI Exhibit number 15.

18

19 --- EXHIBIT NO. MPI-15: Response to Undertaking  
20 number 12

21

22 MS. KATHY KALINOWSKY: Undertaking  
23 number 13 should be marked as MPI Exhibit number 16.

24

25 --- EXHIBIT NO. MPI-16: Response to Undertaking

1 number 13

2

3 MS. KATHY KALINOWSKY: Undertaking  
4 number 14 should be marked as MPI Exhibit 17.

5

6 --- EXHIBIT NO. MPI-17: Response to Undertaking  
7 number 14

8

9 MS. KATHY KALINOWSKY: Undertaking  
10 number 15 should be marked as MPI Exhibit number 18.

11

12 --- EXHIBIT NO. MPI-18: Response to Undertaking  
13 number 15

14

15 MS. KATHY KALINOWSKY: Undertaking  
16 number 16 should be marked as MPI Exhibit number 19.

17

18 --- EXHIBIT NO. MPI-19: Response to Undertaking  
19 number 16

20

21 MS. KATHY KALINOWSKY: Undertaking  
22 number 17 should be marked MPI Exhibit number 20.

23

24 --- EXHIBIT NO. MPI-20: Response to Undertaking  
25 number 17

1 MS. KATHY KALINOWSKY: Undertaking  
2 number 18 should be marked as MPI Exhibit number 21.

3

4 --- EXHIBIT NO. MPI-21: Response to Undertaking  
5 number 18

6

7 MS. KATHY KALINOWSKY: Undertaking  
8 number 19 should be marked as MPI Exhibit number 22.

9

10 --- EXHIBIT NO. MPI-22: Response to Undertaking  
11 number 19

12

13 MS. KATHY KALINOWSKY: Undertaking  
14 number 20 should be marked as MPI Exhibit number 23.

15

16 --- EXHIBIT NO. MPI-23: Response to Undertaking  
17 number 20

18

19 MS. KATHY KALINOWSKY: And finally,  
20 Undertaking number 21 should be marked as MPI Exhibit  
21 number 24.

22

23 --- EXHIBIT NO. MPI-24: Response to Undertaking  
24 number 21

25

1 MS. KATHY KALINOWSKY: Thank you very  
2 much.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: Thank you.

7

8 CONTINUED BY MS. CANDACE GRAMMOND:

9 MS. CANDACE GRAMMOND: So I'm going to  
10 ask you to turn to Tab 25 of the Board's book of  
11 documents, Tab 25. This is PUB/MPI-2-15.

12

13 (BRIEF PAUSE)

14

15 MS. CANDACE GRAMMOND: This is  
16 relative to the issue of the change in assumptions put  
17 forward by the Corporation. And the Board here asked  
18 the Corporation to re-file PF1, which is, of course,  
19 the main financial statement, and PF3, which are the  
20 retained earnings, to reflect each of six (6) changes  
21 in assumptions, and then a cumulative or combined  
22 impact thereof, as well.

23

24 So if we go over to the first  
25 attachment, which is the second page at Tab 25. My  
intention, just so you know what I'm about to do, is



1 to go through each of these and ask for some  
2 commentary on each one. So we'll start with the first  
3 one, which is the -- we -- we asked for a change to  
4 the July 2013 interest update.

5 Can you comment, first of all, maybe on  
6 the base version that's reflected at the very top of  
7 the table, and comment on what was in a -- what was  
8 actually applied for, what the Corporation included in  
9 its Application, relative to an interest rate update?  
10 And then we'll get into how that changed under (a).

11 MS. HEATHER REICHERT: If I can  
12 clarify, did you want to know exactly the interest  
13 rates that we were using, or the methodology that we  
14 used to forecast the interest rates?

15

16 (BRIEF PAUSE)

17

18 MS. CANDACE GRAMMOND: It -- it's more  
19 focussed on the approach, as opposed to the exact  
20 interest rate. And the -- the idea is to just be  
21 clear about the order of magnitude of what the  
22 Corporation is proposing, and then compared with the  
23 alternate scenarios or the alternate assumptions that  
24 are reflected here.

25 MS. HEATHER REICHERT: Okay. So in

1 our Application, and as discussed, I -- I would say,  
2 at some length within the investment section of our  
3 Application, we discussed how we approached the  
4 forecast for interest rates embedded within this  
5 Application and the forecast that supports it.

6                   If I could ask the Board to turn to --  
7 now, this is investment sec -- is Volume II, in the  
8 investment section, page -- page 1. So that's a -- a  
9 horizontal table of all of the investment income  
10 components.

11                   So changes in interest rates impact  
12 most significantly the marketable bond element of our  
13 investment income. So if you look on page 1, down  
14 about the middle of the page -- sorry, it's -- yeah,  
15 in about the middle of the page, where it says, "Gains  
16 During Period Profit and Loss." There is marketable  
17 bonds unrealized gains and losses, marketable bonds  
18 realized gains and losses.

19                   When you look across to the rating  
20 years, which are 2014 and 2015, you can see there  
21 underlying our total investment income what we are  
22 forecasting as the unrealized and realized losses with  
23 respect to marketable bonds in the rating years. So  
24 just for clarity, in '14/'15, marketable bonds  
25 unrealized losses, we forecasted twenty-nine million,

1 four hundred and fifty-two (29,452,000). In '15/'16  
2 we forecasted twenty-eight million, two hundred and  
3 twenty-six (28,226,000); and in realized gains for  
4 2014 nine hundred and forty (940); and in 2015, for  
5 realized losses eleven million, one hundred and ten  
6 (11,110,000). And these are all in thousands of -- of  
7 dollars.

8 As we've talked here previously, in an  
9 environment we are -- where we are forecasting  
10 interest rates to increase, while that negatively  
11 impacts on the value of our bond portfolio, as you can  
12 see with these unrealized and realized losses in the  
13 rating years, it more favourably impacts the value of  
14 our claims liabilities which serves to more than  
15 offset the forecasted losses in the rating years on  
16 the bonds.

17 So if I can just turn to my colleague,  
18 and he may have this close at hand, the in -- the net  
19 positive impact of changing interest rates that is  
20 embedded within the forecast for '14/'15 and '15/'16 -  
21 - do we have it somewhere? One minute.

22

23 (BRIEF PAUSE)

24

25 MS. HEATHER REICHERT: So while Mr.

1 Johnston is -- is getting me that number, just so that  
2 you have in your head, in the rating years '14/'15 and  
3 '15/'16, the total -- the approximate total, if I can  
4 add quickly in my head, the approximate total of the  
5 forecasted losses with respect to the increasing  
6 interest rates relative to the bonds, is about \$68  
7 million -- 68, \$69 million. The impact of forecasting  
8 increasing interest rates on our claims liability,  
9 again, for those same two (2) years -- okay, so our  
10 math is -- is not working for us today. So we will  
11 get that number.

12 Suffice to say, as we have talked here  
13 before, the net impact of increasing interest rates is  
14 favourable to the Corporation in that the negative  
15 aspects to our bonds is more than offset by the  
16 positive impact to our claims liabilities. So getting  
17 back to -- and I apologize for such a large preamble  
18 for your -- for your question, but getting back to  
19 underlying the base assumption that is on this page 1  
20 of Tab 25, embedded within the net numbers on the 2014  
21 projection and the 2015 projection, will be a positive  
22 number.

23 And that positive number, plus the  
24 assumption within the base, is that we have a 1.8  
25 percent rate increase. So with a 1.8 percent rate

1 increase with the forecasted increasing interest  
2 rates, as we've talked about here before, that  
3 presented us with a net income of 5,472,000 in 2014, a  
4 negative 7,494,000 in 2015. and as we talked about  
5 previously, we look at the two (2) years, the average,  
6 which is on average a loss of 2.5 million, which is  
7 considered close enough to break even for rate setting  
8 purposes.

9                   Okay. So that -- is that helpful with  
10 -- with respect to what's underlying that base number?  
11 And we will get you what the net impact.

12

13   (BRIEF PAUSE)

14

15                   MS. HEATHER REICHERT: So I -- I do  
16 have that number for you now. So the -- the net  
17 favourable impact over the two (2) years of the rating  
18 period for assuming an increasing interest rate  
19 environment, is 21 million. Now, that's over both  
20 years. So it's not each year. It's 21 million over  
21 the two (2) years, just to give some sense.

22                   MS. CANDACE GRAMMOND: Now, I  
23 understand that the interest rate used by the  
24 Corporation in preparing the base assumption, or the  
25 base version as it's referenced here, was interest --

1 interest rates as of April of 2013.

2 Is that right?

3 MS. HEATHER REICHERT: That is  
4 correct. They were interest rates that were  
5 forecasted as at April 2013 where we took the bank  
6 forecasts, which they assumed would occur --  
7 increasing interest rates would occur over five (5)  
8 years, and for the rating years we assumed that those  
9 increases occurred more slowly. And -- but they were  
10 the bank interest rates instead of occurring over five  
11 (5) years, occurring over ten (10) years. And that  
12 was what was used within our base forecast within the  
13 GRA.

14 MS. CANDACE GRAMMOND: So what the  
15 Board asked in this IR at (a) was to, in essence, re-  
16 run the numbers using an updated interest rate now  
17 that some time had gone by, and that would be an  
18 interest rate as of July of 2013.

19 So is that what we see the impact in  
20 line A?

21 MS. HEATHER REICHERT: Correct. So we  
22 -- now, to be very clear, we used the methodology  
23 requested by the Board which was using the bank  
24 forecasts in July of 2013 and forecasting as MPI had  
25 forecasted in previous GRA applications. So not

1 taking the bank interest rates over five (5) years,  
2 and assuming that they would occur over ten (10).  
3 Taking the bank interest rates forecasted over the  
4 five (5) years, as we had in the past, taking the  
5 average of those and applying it to the rating years.

6 MS. CANDACE GRAMMOND: Thank you.

7 And, so we see for the 2014/'15 fiscal year, which is  
8 listed here as 2014-P, we see that the Basic net  
9 income increased under that set of assumptions to  
10 about over 37 million from the five point four (5.4)  
11 as applied?

12 MS. HEATHER REICHERT: That is  
13 correct.

14 MS. CANDACE GRAMMOND: And similarly  
15 the retained earnings for the same year increased to  
16 179.1 million from a hundred and forty-six point nine  
17 (146.9) as reflected in the Application.

18 MS. HEATHER REICHERT: Correct.

19 MS. CANDACE GRAMMOND: And going  
20 forward, again we see more positive results for the  
21 2015 and 2016 fiscal years, both in terms of net  
22 income and retained earnings.

23 MS. HEATHER REICHERT: Yes.

24 MR. REGIS GOSSELIN: Could we quantify  
25 that interest rate increase that we used for the

1 projection that you're referring to?

2

3

(BRIEF PAUSE)

4

5

MS. HEATHER REICHERT: If -- if you  
6 would like. I -- I think it's helpful, at least it's  
7 helped me, to understand what the actual interest  
8 rates that we're using underneath each of these  
9 forecasts.

10

So, for instance, in our base forecasts  
11 submitted with our GRA -- and I'm just -- I'm just  
12 going to give you -- I'll just give you year-end  
13 interest rates, just to -- to give some sense.

14

So in our base GRA interest rate  
15 forecast, at the end of 2013/'14, our fiscal year, we  
16 used in the forecast 2 percent. At the end of '14/'15  
17 the interest rate that we were using was 2.32 percent.  
18 And I'll stop at this next one, at the end of 2015/'16  
19 the interest rate that we were using was 2.67 percent.

20

Now, we had interest rates use -- we  
21 were using interest rates at the end of each quarter  
22 within our financial model itself. I'm just giving  
23 you the -- the year-end rates, so the -- it increased  
24 to those numbers during the quarters.

25

The July standard rate forecast that



1 you see in this exhibit, instead of 2 percent at the  
2 end of '13/'14 it was using 2.44 percent. At the end  
3 of 2014/'15 it used 2.58 percent. And at the end of  
4 '15/'16 it used a whopping 2.86 percent. So I think  
5 that the magnitude -- if you can see the magnitude of  
6 the increases in the interest rate assumptions is what  
7 is contributing to the significant higher positive  
8 impacts that you see at Line A on this particular  
9 document.

10 Does that help? Is that helpful?

11

12 (BRIEF PAUSE)

13

14 CONTINUED BY MS. CANDACE GRAMMOND:

15 MS. CANDACE GRAMMOND: So, Ms.  
16 Reichert, to be clear, what we see here at Line A and  
17 then in the shaded portion underneath it says,  
18 "Difference to base." Those differences are driven by  
19 two (2) things compared with what MPI applied for.  
20 One (1) is the updated interest rate from April to  
21 July and the other is the -- the tempering of the  
22 forecast period from ten (10) years to five (5) years.

23 Is that right?

24 MS. HEATHER REICHERT: Which, of  
25 course, that tempering is what impacted on the

1 different interest rate forecasts. So the difference  
2 between the base and the standard at 'A' is a  
3 difference in the interest rate forecast. We arrived  
4 at them -- yes, we did arrive at them two (2)  
5 different ways, but fundamentally the only difference  
6 between those two (2) is the assumed interest rate  
7 between our forecast and 'A' -- Line A.

8 MS. CANDACE GRAMMOND: Now, on the  
9 basis of the numbers that we see at (a) with the  
10 changes that you've described, or that we've been  
11 describing, would it be fair to say that on the basis  
12 of those numbers for 2014 and 2015, since we take the  
13 two (2) years together, that there would be a change  
14 in the rate increase that's being applied for, if  
15 those were the Corporation's numbers?

16 And if so, can you describe how that  
17 would change?

18 MS. HEATHER REICHERT: So if the  
19 Corporation believed the forecast at Line A, which  
20 we've discussed why -- why we've got concern with  
21 assuming that high of an interest rate increase over  
22 the rating years, but if we believe those interest  
23 rate forecasts to be appropriate, what this would tell  
24 us is that the average on those rating years is 45  
25 million divided by two (2), so 22 1/2 million, at 8

1 million equalling 1 percent. That would indicate  
2 approximately two point seven (2.7) -- I don't know,  
3 something like that, two point seven (2.7) rate  
4 reduction, but that's after -- this is already  
5 assuming a 1.8 percent increase.

6                   So it would be less than a percent  
7 reduction if these had been the interest rates that we  
8 had submitted to the Board. But I do just want to  
9 reiterate, the higher that we forecast the interest  
10 rates to increase, the greater the risk to the  
11 Corporation, should those interest rates not come to  
12 fruition, because we're counting on a -- a lot of  
13 income that if it doesn't happen will detrimentally  
14 impact the financial stability of MPI.

15                   MS. CANDACE GRAMMOND: Thank you. So  
16 we talked about 'A', the -- relating to the interest  
17 rates. I now want to talk about line item B, which is  
18 entitled, "Dividend Yield Forecast." So what I'd ask  
19 you to do for starters, at a high level, is to  
20 describe what the Corporation included in the  
21 Application and then we'll talk about this alternate  
22 scenario that we see at 'B'.

23

24

(BRIEF PAUSE)

25

1 MS. HEATHER REICHERT: Okay. So I  
2 believe in this scenario what we forecasted within the  
3 GRA was we forecasted the Canadian equity dividend  
4 yield to be 3.2 percent over the entire five (5) year  
5 forecast. We...

6

7 (BRIEF PAUSE)

8

9 MS. HEATHER REICHERT: Oh. And -- I'm  
10 sorry. And for the US equities we assumed a dividend  
11 of 2.4 percent. So that's what is in our base  
12 forecast. This particular IR asked us to, instead of  
13 using an average over all five (5) years of our  
14 forecast, to actually grow, if you will, the dividend  
15 -- the dividend income, so not using an average but  
16 building it 2013/'14 using 3.1 percent, '14/'15 using  
17 3.2 percent, and then '15/'16 using 3.4 percent.

18 Similarly, on the US dividend side,  
19 instead of using an average throughout the forecast  
20 period, to grow it from 2.3 percent to 2.4 percent in  
21 '14/'15, and then 2.6 percent in '15/'16. Yes? No?  
22 Is that not what the question is?

23 MS. CANDACE GRAMMOND: No, I -- I  
24 wasn't shaking my head at you.

25

1 (BRIEF PAUSE)

2

3 MR. REGIS GOSSELIN: Do you mind  
4 repeating those again, please, if you don't mind.

5 MS. HEATHER REICHERT: Sure. I'd be  
6 happy to. So the base forecast assumes an average, a  
7 steady average throughout. Canadian dividend 3.2, US  
8 dividend 2.4, so each year of the forecast the same  
9 percentage assumption.

10 This particular IR asked us to start  
11 with, in the Canadian for '13/'14, 3.1 percent;  
12 '14/'15, 3.2 percent; and '15/'16, 3.4 percent. And  
13 then for any years past '15/'16 keep it at 3.4  
14 percent. Similarly, on the US dividend side, this  
15 particular IR asked us to start with 2.3 percent for  
16 2013/'14, 2.4 percent for '14/'15, 2.6 percent for  
17 '15/'16 and thereafter.

18

19 (BRIEF PAUSE)

20

21 CONTINUED BY MS. CANDACE GRAMMOND:

22 MS. CANDACE GRAMMOND: Thank you.  
23 Now, Ms. Reichert, when we compare that revised -- or  
24 those revised forecasts, as requested by the Board at  
25 'B' to what MPI has applied for, we don't see a huge

1 variance. We -- if we look at the shaded section  
2 under 'B' we see what the changes are both to net  
3 income and retained earnings. And the numbers are, by  
4 our standards, fairly small.

5 Is that fair to say?

6 MS. HEATHER REICHERT: Yes, it is.

7

8 (BRIEF PAUSE)

9

10 MS. CANDACE GRAMMOND: So flowing from  
11 that it would be fair so say that this particular  
12 change, if it was included in the Corporation's rate  
13 application, wouldn't have a material impact on the  
14 1.8 overall rate in pers -- rate increase that is  
15 being asked for?

16 MS. HEATHER REICHERT: That is  
17 correct. It would have no impact.

18

19 (BRIEF PAUSE)

20

21 MS. CANDACE GRAMMOND: Now, I  
22 understand that the Corporation is considering  
23 changing the modelling for next year to include the  
24 approach suggested by the Board.

25 Is that right?

1 MS. HEATHER REICHERT: To include the  
2 balance sheet in the financial forecast? Yes.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: So the  
7 Corporation's approach would be to take the average of  
8 forecasts set out by forecasters such as Bloomberg?

9 MS. HEATHER REICHERT: As it relates  
10 to this dividend forecast specifically?

11 MS. CANDACE GRAMMOND: Yes.

12 MS. HEATHER REICHERT: Well, we can --  
13 okay, this year we used the average, as I explained.  
14 We do, because of the -- the capabilities of the  
15 financial model, we could put in specific different  
16 dividend rates for each of the years, as I articulated  
17 that we did for the purposes of this IR. So we will  
18 look at what is deemed to be the most reasonable  
19 forecast for dividend income at the time that we do  
20 the forecasting. So it may be an average if it's not  
21 making a whole lot of difference, or it may be a  
22 growth in that over time if that makes the most sense.  
23 We will -- we will look at that as we forecast.

24

25 (BRIEF PAUSE)

1 MS. CANDACE GRAMMOND: Ms. Reichert,  
2 are you suggesting that the Corporation is going to  
3 impose its judgment onto Bloomberg, for example, one  
4 (1) of the forecasters?

5 MS. HEATHER REICHERT: No.

6 MS. CANDACE GRAMMOND: Thank you. So  
7 moving then to the third item, which is (c). This  
8 deals with a change in the Canadian equity return  
9 percentage or percentile. Again, can you comment,  
10 first off, on how the Corporation dealt with this  
11 aspect within the application as filed? And then  
12 we'll come to the alternate version.

13

14 (BRIEF PAUSE)

15

16 MS. HEATHER REICHERT: So for Canadian  
17 equity return we, in the base forecast, used 6.2  
18 percent. In this particular IR we were asked to use  
19 7.2 percent.

20

21 (BRIEF PAUSE)

22

23 MS. CANDACE GRAMMOND: Now --

24

25 (BRIEF PAUSE)



1 MS. HEATHER REICHERT: Sorry.

2 MS. CANDACE GRAMMOND: Ms. Reichert, I  
3 understand that the 6.2 percent used by the  
4 Corporation in the application was based on a twenty  
5 (20) year rolling minimum average. That's right?

6 MS. HEATHER REICHERT: Yes.

7 MS. CANDACE GRAMMOND: And can you  
8 comment on how an assumption that's based on a minimum  
9 can be consistent with providing a best-estimate  
10 forecast?

11

12 (BRIEF PAUSE)

13

14 MS. HEATHER REICHERT: So in -- in the  
15 past, the Corporation had in -- used an equity risk  
16 premium to forecast for equity return. The equity  
17 risk premium, I think, actually was last year when we  
18 were looking at it, gave a very, very low return for  
19 equities, at 4.8 percent. So rather than use the  
20 equity risk premium that seemed to be abnormally low,  
21 we moved to the twenty (20) year minimum which is the  
22 6.2 percent. So it's considered to be a better  
23 estimate than the equity risk premium estimate that we  
24 would have used prev -- in previous years.

25 And I -- I do recall that the Board

1 accepted in -- in their orders, recommended that we  
2 use the twenty (20) year minimum.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: But I  
7 understand the Corporation's evidence, or your  
8 evidence, Ms. Reichert, with respect to this approach.  
9 The -- the approach now being put forward by the  
10 Corporation being an improvement over the use of the  
11 equity risk premium and being a better estimate.

12 But what I'm trying to -- to get to is  
13 the notion, and given the definition of 'best  
14 estimate' that Mr. Johnston and I discussed earlier,  
15 how does that reconcile or dovetail with there being a  
16 minimum rolling average being used? Isn't that  
17 somewhat potentially inconsistent?

18

19 (BRIEF PAUSE)

20

21 MS. HEATHER REICHERT: So we chose to  
22 use this minimum rolling average, again as I said, to  
23 improve the estimates from prior years. When we use  
24 the premium equity risk -- or equity risk pre --  
25 premium, and we see such a low estimate, we did not

1 believe that was a best reasonable estimate for  
2 equities.

3                   So we moved to establishing a minimum  
4 amount for the equity -- the equity forecast. And so  
5 what was really available was the twenty (20) year  
6 rolling average returns for -- for equities. So we do  
7 feel that it is at this point in time a best estimate  
8 given the information that we have, and is better than  
9 the equity risk premium one that was giving a  
10 substantially lower rate and we didn't think that that  
11 was reasonable.

12                   MS. CANDACE GRAMMOND:    Okay.  So, Ms.  
13 Reichert, looking then at the information relative to  
14 item C, we see again that the impact of the change put  
15 forward in the IR to seven point two (7.2) from six  
16 point two (6.2) has not a lot of impact in the year of  
17 the Application, has a bit more impact in 2015/'16.

18                   Would you agree?

19                   MS. HEATHER REICHERT:    I would agree.  
20 Again, on average -- this would average out to being  
21 less than 1.5 million, so not at all a significant  
22 impact of rates.

23                   MS. CANDACE GRAMMOND:    Thank you.  And  
24 I'm -- I'm looking, of -- of course, just for the  
25 record, to the shaded area entitled "Difference to

1 Base" that shows an improvement of four hundred and  
2 forty-nine thousand dollars (\$449,000) in net income,  
3 and the same in retained earnings for the year of the  
4 Application.

5                   So moving then to item D. We've just  
6 been talking about Canadian equity returns. Item D  
7 deals with US equity returns. Can you comment on how  
8 the Corporation arrived at that component within the  
9 Application?

10                   MS. HEATHER REICHERT: So within our  
11 base forecast the US equity investment income of the  
12 US return was forecasted at 6.2 percent. It matched  
13 the Canadian equity return. And in this particular IR  
14 we were asked to use 7.6 percent US equity return,  
15 which was based on the 5th percentile of the twenty  
16 (20) year.

17

18                   (BRIEF PAUSE)

19

20                   MS. HEATHER REICHERT: And maybe I can  
21 just at this moment, just to correct the record, both  
22 Ms. Grammond and I were quoting from the wrong columns  
23 in the last summary that Ms. Grammond did and -- and I  
24 did with respect to the impact of line item C.

25                   The impact of line item C to the base

1 forecast, we need to be looking at the 2015 projected  
2 and the 2016 projected. Those are the year-ends  
3 2014/'15 and 2015/'16. And we were quoting the  
4 2013/'14 year and the 2014/'15 year.

5                   So to correct the record, the impact of  
6 the 7.2 percent Canadian equity return would have been  
7 in 2015 column P, a negative five million one hundred  
8 and sixty-four (5,164,000). And in 2016 -- or sorry,  
9 the -- the net impact was the two million three  
10 hundred and twenty-nine (2,329,000) in 2015. In 2016,  
11 the one million two hundred and thirty-four  
12 (1,234,000). The response is still the same.

13                   The average of those two (2) changes  
14 over the rating period would have been three (3) point  
15 -- it would have been a million two (1,200,000) and  
16 still not significant to have impacted on the -- on  
17 the requested rates. So I apologize, we were just  
18 referring to the wrong columns.

19                   MS. CANDACE GRAMMOND: Thank you, Ms.  
20 Reichert. So -- so if I understand you correctly,  
21 you're saying the first column shown as 2013-A is  
22 2012/'13 fiscal year actual. The second column, 2014-  
23 P, is actually current year. And 2015-P is the year  
24 of application, 2016-P is the year subsequent.

25                   MS. HEATHER REICHERT: Correct.

1 MS. CANDACE GRAMMOND: Okay. Tha --  
2 thank you for clarifying that. That's probably my  
3 fault for leading us down that road in the first  
4 instance. So let's -- let's finish off with C then.  
5 As you've indicated, they're -- the impacts are  
6 different than what we talked about but still wouldn't  
7 change the overall rate application?

8 MS. HEATHER REICHERT: That's correct.

9 MS. CANDACE GRAMMOND: And probably  
10 the same could be said about item B, again, the  
11 impacts are not material and -- and wouldn't impact  
12 the rate application?

13 MS. HEATHER REICHERT: Yes, that's  
14 correct, because there you have about a \$4 million  
15 combined difference which, on average, is 2 million,  
16 and again would not si -- would not impact the rate.

17 MS. CANDACE GRAMMOND: And just to  
18 back to 'A' for a minute because we do see the numbers  
19 change more on the 'A' item. Do you have any --  
20 anything that you want to add to or change your  
21 evidence about 'A'?

22 MS. HEATHER REICHERT: Yes, because if  
23 you now look at 2015-P, 2016-P, the total of those two  
24 (2) year impacts would be 23 million, which would mean  
25 on average it would be eleven million five hundred

1 (11,500,000). And that would -- given 8 million is  
2 about a percent, that would be approximately a 1 1/2  
3 percent decrease on an already assumed 1.8 percent  
4 increase.

5 So it does, you know, change the math a  
6 little bit. But again, it would essentially negate  
7 the requested rate increase.

8 MS. CANDACE GRAMMOND: Thank you.  
9 Okay. So now that we've got that set out on the right  
10 track, we were down at 'D' talking about the US equity  
11 return and the alternate scenario that -- that the  
12 Board asked the Corporation to put forward.

13 Again we see the -- under the  
14 difference to base, the shaded areas, there's not a  
15 material impact with respect to 'D' that I assume  
16 would not affect the pending rate application?

17 MS. HEATHER REICHERT: That is  
18 correct.

19 MS. CANDACE GRAMMOND: Okay. So going  
20 then to 'E'. The line item is entitled "IPD Canada."  
21 And I don't have a reference at my fingertips as to  
22 what 'IPD' stands for.

23 Can you comment with respect to that  
24 aspect of the Application?

25

1 (BRIEF PAUSE)

2

3 MS. HEATHER REICHERT: It stands for  
4 investment property something, and it is the -- the  
5 real estate return benchmark.

6 MS. CANDACE GRAMMOND: Thank you. So  
7 can you comment, again, as we've been doing for each  
8 of these, what the Corporation included in the  
9 Application as filed with respect to this piece?

10

11 (BRIEF PAUSE)

12

13 MS. HEATHER REICHERT: Okay. In our  
14 base forecast we assumed a 6 percent return in the  
15 rating years, and that was based on CPI plus 4  
16 percent. I'm sorry. That was the base return and  
17 then we were asked within here to assume...

18

19 (BRIEF PAUSE)

20

21 MS. HEATHER REICHERT: In this  
22 specific request we used a 7.8 percent capital return.

23 MS. CANDACE GRAMMOND: Thank you. And  
24 we see under the revised scenario for the current  
25 year, which is labelled, "2014-P," we have an increase



1 in net income of about 4.8 million, and subsequent  
2 increases for the year of the application and so  
3 forth?

4 MS. HEATHER REICHERT: Correct.

5 MS. CANDACE GRAMMOND: And can you  
6 comment on whether these increases in net income would  
7 be significant enough to alter the Rate Application  
8 presently before the Board?

9 MS. HEATHER REICHERT: Probably  
10 unlikely, in that the average of these two (2) is  
11 about 4 million, and applied against what we already  
12 said was the remaining average based on a rate  
13 application of about two-point-five (2.5) negative, if  
14 you took those two (2) together, netting to about a  
15 one point five (1.5) positive average result, would  
16 not be something that would impact on the rate.

17 MS. CANDACE GRAMMOND: Thank you. And  
18 lastly, or second-lastly I guess, prior to the  
19 combined scenario we see the amortization correction  
20 issue.

21 Can you comment on what that relates  
22 to?

23 MS. HEATHER REICHERT: In -- within  
24 the forecast there was a -- an input error made that  
25 resulted in us overstating amortization for some data

1 processing equipment by about 1.2 million. And when  
2 you look at the impact of that, had -- had it  
3 reflected the correct amortization, our forecasted  
4 expense for 2015 would have increased by the 1.2  
5 million, and 2015/'16 negligible. So, again, on an  
6 average over the rating period basis, about six  
7 hundred thousand (600,000). So it would not have  
8 impacted what we were asking for in rates, which is  
9 why we did not amend our rate application.

10 MS. CANDACE GRAMMOND: And just to be  
11 clear about that difference, as applied for, for that  
12 2015 year end, the Corporation is projecting a net  
13 loss of about 7.5 million. That loss decreases to 6.3  
14 million reversing the -- the data entry error that was  
15 made.

16 MS. HEATHER REICHERT: Yes, that's  
17 true.

18 MS. CANDACE GRAMMOND: Okay. So going  
19 then to the very bottom rows we see, if I understand  
20 it correctly, the numbers reflecting all of these  
21 adjustments. Because as we've gone through in this  
22 level of detail between 'A' and 'F', some of the  
23 alternate scenarios have resulted in greater funds for  
24 the Corporation, some in lesser. So this -- this very  
25 bottom scenario brings everything together as if all

1 six (6) of these changes asked about by the Board were  
2 implemented in the Application.

3 Is that right?

4 MS. HEATHER REICHERT: Yes, that is  
5 true.

6 MS. CANDACE GRAMMOND: So for the  
7 current year we see -- and again I'm just looking at  
8 the very bottom, we see increased net income of 37  
9 million, and for the year of the Application we see  
10 increase net income of 22.3 million.

11 MS. HEATHER REICHERT: Yes.

12 MS. CANDACE GRAMMOND: So I assume  
13 based on these numbers that if all of these changes  
14 were implemented within the Application, the request  
15 being made by the Corporation for an overall one point  
16 eight (1.8) rate per -- rate increase would be  
17 changed.

18 Would that be fair to say?

19 MS. HEATHER REICHERT: Yes, that is  
20 fair to say. And again I'll just reiterate, the total  
21 impact on the rating years that we see under 2015-P  
22 and 2016-P, the majority of that relates to the issue  
23 of what you choose as an interest rate forecast and,  
24 as we've said, the -- the risk that the Board and --  
25 is willing to accept in that interest rate forecast

1 being too high or too low.

2 MS. CANDACE GRAMMOND: Thank you. And  
3 just before we leave this document, I just wanted to  
4 go back and clarify some of your earlier evidence.  
5 When we were talking about item C and the equity  
6 returns, I think you had stated that the Board had  
7 previously endorsed the use of a twenty (20) year  
8 minimum rolling average equity return.

9 We've been looking for the specific  
10 reference for that, and we're wondering if you can  
11 help. We have -- have -- having some difficulty  
12 pinpointing it.

13 MS. HEATHER REICHERT: My recollection  
14 is -- is in last year's order where -- and I'll -- I'm  
15 just looking to our general counsel 'cause she might  
16 be able to lay her hands on that more quickly.

17 MS. CANDACE GRAMMOND: I can just  
18 assist maybe further by stating we've looked at last  
19 year's order here, and what we are finding is that the  
20 Board accepted MPI's use of a 5th percentile return as  
21 a minimum imposed on an equity return based on bond  
22 returns and a risk premium. So it's a little bit  
23 different than what you had said.

24 MS. HEATHER REICHERT: Okay. Noted.

25 MS. CANDACE GRAMMOND: It's page 33 of

1 last year's order, which I believe was Order 157/'12.

2

3

(BRIEF PAUSE)

4

5

MS. HEATHER REICHERT: No, it's noted  
6 what you -- what you read in, and we understood that  
7 the Board was endorsing how we had forecasted the  
8 equity returns in last year's GRA and that that  
9 wording was not reflective of how we had actually done  
10 the forecast last year. So we saw it as an  
11 endorsement of how we had done it last year and did it  
12 the same way in this year.

13

14

(BRIEF PAUSE)

15

16

MR. REGIS GOSSELIN: Ms. Reichert,  
17 could I ask you to clarify some numbers for me,  
18 please. I -- I just want to make sure my notes are  
19 correct.

20

The -- the Application contained  
21 Canadian equity returns of...? What was the  
22 percentage?

23

MS. HEATHER REICHERT: Sorry.  
24 Canadian equity returns at 6.2 percent.

25

MR. REGIS GOSSELIN: Six point two

1 (6.2). And in the US was?

2 MS. HEATHER REICHERT: Also six point  
3 two (6.2) --

4 MR. REGIS GOSSELIN: Six point two  
5 (6.2). And the -- the alternative IPD Canada return  
6 was what? I know the base was six (6) but what was  
7 the --

8 MS. HEATHER REICHERT: The base was  
9 six (6) and within this question it was -- no -- yeah.  
10 Okay. The base -- sorry, the base was CPI plus four  
11 (4), so it would change as CPI is forecasted to  
12 change. And within this particular IR we used 7.8  
13 percent.

14

15 (BRIEF PAUSE)

16

17 MS. HEATHER REICHERT: If -- if I may,  
18 we've -- we've just located the -- the reference  
19 within the order. So with -- this is page -- I'm  
20 sorry, this is page 33 of 63 from the Board order last  
21 December, 2012:

22 "The Corporation has proposed  
23 therefore adding a minimum equity  
24 return to the existing methodology  
25 based on the 5th percentile of

1 annual returns on the TSX over all  
2 rolling twenty (20) year periods.  
3 The 5th percentile was 6.1 percent  
4 as of February 29th, 2012, and the  
5 use of the revised forecast  
6 methodology yields a minimum  
7 forecasted annual equity return of  
8 6.1 percent, which MPI has  
9 incorporated in this application."

10

11 (BRIEF PAUSE)

12

13 MS. CANDACE GRAMMOND: Thank you, Ms.  
14 Reichert. And just following on that before I move to  
15 another area, what we're struggling with on that issue  
16 is -- is as follows, I'm going to ask you to go to  
17 PUB/MPI-1-28 from this year. It's not in the book.

18

19 (BRIEF PAUSE)

20

21 MS. HEATHER REICHERT: I'm there.

22 MS. CANDACE GRAMMOND: So if you go to  
23 the answer at (e), which appears at the top of page 3  
24 you'll see the Corporation has stated:

25

"Last year the 5th percentile equity

1 return was incorrectly calculated  
2 due to an error in the spreadsheet.  
3 The correct historical 5th  
4 percentile equity return is 7.2  
5 percent and the correct minimum  
6 historical return is 6.2 percent."

7 And so forth. So what -- what we want  
8 to make sure we understand is if there was an error  
9 last year, is that error being perpetuated within this  
10 year's filing?

11 MS. HEATHER REICHERT: No.

12

13 (BRIEF PAUSE)

14

15 MS. CANDACE GRAMMOND: I guess the  
16 question is -- what was accepted last year was using  
17 the 5th percentile and what's been used this year is a  
18 minimum. So there is a difference there, is there  
19 not?

20

21 (BRIEF PAUSE)

22

23 MS. HEATHER REICHERT: Both this year  
24 and last year the intent was to use the minimum twenty  
25 (20) year -- what is it, the twenty (20) year rolling



1 return. And so that was the intent last year. That  
2 was what we understood that was accepted by the Board  
3 and that was we had calculated to use in this forecast  
4 this year.

5 MS. CANDACE GRAMMOND: Thank you.

6

7 (BRIEF PAUSE)

8

9 MS. CANDACE GRAMMOND: Thank you. I'm  
10 going to move then to a newer area, still dealing with  
11 interest rate risk. So I'd ask you to go to the 'II'  
12 section, so the investment income section of the  
13 filing, which is in Volume II. You had directed us to  
14 a document there not that long ago, Ms. Reichert. And  
15 I'm on page 5. Sorry, I'm on page 7. So this is  
16 Volume II, the investment income section, II.1, page  
17 7. And at the very top of page 7 there's the heading,  
18 "Table 1.1." Do we all have that?

19 So we see from looking at that table  
20 that a fifty (50) basis point decline in interest  
21 rates in the current year, 2013/'14, leads to an  
22 increase in the corporate investment income for the  
23 current year of about \$40.6 million.

24 Is that right?

25 MS. HEATHER REICHERT: Yes.

1 MS. CANDACE GRAMMOND: Now, in part,  
2 this in -- investment income shift would be the result  
3 of an increase in the market value of the marketable  
4 bond portfolio leading to an increase in unrealized  
5 gains and losses on investments, which flows through  
6 net income because of the characterization of these  
7 assets as fair value through profit and loss.

8 Is that right?

9 MS. HEATHER REICHERT: Yes, it is.

10 MS. CANDACE GRAMMOND: Now, compared  
11 to the \$40.6 million that -- that are shown here, can  
12 you comment on how big the effect would be?

13 MS. HEATHER REICHERT: I'm sorry, can  
14 you repeat the question.

15 MS. CANDACE GRAMMOND: Thanks. So  
16 we've -- we've looked at the 40.6 that would result  
17 from a fifty (50) basis point decline. And then the  
18 next part of my question was that in -- in part, this  
19 investment income shift would be the result of an  
20 increase in market value of the marketable bond  
21 portfolio leading to an increase in unrealized gains  
22 and losses on investments which flows through net  
23 income because the assets are characterized as FVTPL,  
24 or fair value through profit and loss?

25 MS. HEATHER REICHERT: Right. I -- I

1 agreed with that statement.

2 MS. CANDACE GRAMMOND: So comparing  
3 that to the \$40.6 million effect shown in Table 1.1,  
4 can you comment on the difference or how big the  
5 effect would be?

6

7 (BRIEF PAUSE)

8

9 MS. HEATHER REICHERT: I'm sorry, I  
10 think I need further clarification. This calculation  
11 that we did here assumed if there were a fifty (50)  
12 basis point lower interest rate than what we had  
13 forecasted in our base scenario, the impact to our  
14 bond portfolio would be to increase it by -- by forty  
15 point six (40.6) and reflect an unrealized gain  
16 through our net income. That is what this is saying.

17 So I'm -- I'm -- the impact to -- now,  
18 at the same time that a fifty (50) basis point  
19 decrease in interest rates is positively impacting our  
20 bond portfolio, it's also negatively impacting our  
21 claims incurred. So the net impact on our model is a  
22 negative 17.3 million.

23

24 (BRIEF PAUSE)

25

1 MS. CANDACE GRAMMOND: Okay, Ms.  
2 Reichert, I'm just going to ask you to -- to set aside  
3 in your mind for the moment the impact on the claims.  
4 And we're just going to talk about the -- the impact  
5 on investment income.

6 I understand that there are two (2)  
7 components. One (1) is the market value effect of a  
8 change in interest rate, and the other is a change in  
9 income. And that's due to the yield on new  
10 investments.

11

12 (BRIEF PAUSE)

13

14 MS. HEATHER REICHERT: Okay, maybe I  
15 can approach it this way. So I appreciate with  
16 respect to marketable bonds there are two (2) main  
17 components that will impact the investment income of  
18 the Corporation. One (1) is the actual coupon rate of  
19 the bond itself, and the second is the market value of  
20 that bond. As interest rates go up or down, the  
21 market value of that bond will decrease or increase.  
22 So the coupon income from the entire portfolio, that  
23 would change if we bought and sold bonds during the  
24 year. If we bought a bond at the beginning of the  
25 year and kept it the entire year, the coupon rate for

1 that bond would not change. T

2 he second component, the change in the  
3 market value of the bond due to the changes in  
4 interest rates, as -- as we've said many times, if the  
5 interest rates were increasing the value of our bonds  
6 would decrease and it would have a negative impact on  
7 our investment income. Conversely, if interest rates  
8 were to fall, as in this example at the top of Table  
9 1.1, if interest rates fall, the value of our bond  
10 would increase and positively impact our net income.  
11 Does that help?

12 So just to be clear, both of the  
13 impacts I just talked about, so changing coupon rates  
14 as we buy and sell bonds and the change in the market  
15 value of the bonds as interest rates increase or  
16 decrease are all included within the model and are all  
17 reflected in the forty point six (40.6) that you see  
18 in this particular example.

19 MS. CANDACE GRAMMOND: Thank you.

20 MR. REGIS GOSSELIN: A small point,  
21 but the parentheses on these table could be amended,  
22 right?

23 MS. HEATHER REICHERT: I know.

24

25 CONTINUED BY MS. CANDACE GRAMMOND:

1 MS. CANDACE GRAMMOND: Ms. Reichert,  
2 just to confirm then, the \$40.6 million change that we  
3 see here in Table 1.1 is dominated by the change in  
4 market value.

5 Is that right?

6 MS. HEATHER REICHERT: Absolutely.

7 MS. CANDACE GRAMMOND: Now, would you  
8 agree this effect, this change in investment income  
9 that we've been speaking about, is isolated -- sorry,  
10 I misspoke. The market value effect that we've been  
11 speaking about is isolated to the accounting period in  
12 which the interest rate shift occurs.

13 Is that right?

14 MS. HEATHER REICHERT: Yes, that's  
15 correct.

16 MS. CANDACE GRAMMOND: Now, is it also  
17 true that the increase in 2013/'14 investment income  
18 is dampened by the interest rate decline due to a  
19 decline in coupon income on bonds purchased in the  
20 period, relative to what it otherwise would have been  
21 without the change in interest rates?

22 MR. REGIS GOSSELIN: For my benefit,  
23 could you repeat that please?

24

25 CONTINUED BY MS. CANDACE GRAMMOND:

1 MS. CANDACE GRAMMOND: Yeah, of  
2 course. Okay. So is it true that the increase in  
3 2013/'14 investment income is dampened by the interest  
4 rate decline due to a decline in coupon income on  
5 bonds purchased in the period, relative to what it  
6 otherwise would have been but for the interest rate  
7 change?

8 MS. HEATHER REICHERT: Are we still  
9 looking at Table 1.1 at the top of the page?

10 MS. CANDACE GRAMMOND: Yes.

11 MS. HEATHER REICHERT: Okay. So the -  
12 - the theoretical de -- if interest rates were fifty  
13 (50) basis points less than forecast in '13/'14, the  
14 impact would be the 40.6 million increase in the value  
15 of those bonds -- you know what? Just one (1) more  
16 time. Repeat the question and I'll answer it really  
17 clearly.

18

19 (BRIEF PAUSE)

20

21 MS. CANDACE GRAMMOND: Okay. So what  
22 I'm trying to get at is that the 40.6 million that we  
23 see here in Table 1 is actually the result of two (2)  
24 numbers; that the market value shift is actually  
25 greater than this, but the number comes down to 40.6

1 because of the decline in coupon income on new  
2 investments?

3 MS. HEATHER REICHERT: Yes, because in  
4 this example we are assuming that interest rates are  
5 decreasing below our forecast. So, therefore, if  
6 we're buying and selling bonds in that scenario, the  
7 coupon rate that we're going to get is lower than what  
8 we currently would be holding bonds at. So I'm  
9 agreeing with your comment, it is a net impact of two  
10 (2) numbers.

11 MS. CANDACE GRAMMOND: So the next  
12 question is: How much is that impact? So what --  
13 what is the reduction from what to the 40.6 million?

14 In other words, how much did the number  
15 come down by when the offset was applied?

16 MS. HEATHER REICHERT: I'll take that  
17 as an undertaking and get back to you. I can say --  
18 I'm sorry? I can say that the impact of the change in  
19 the coupon rate is a very, very small impact relative  
20 to the change in the interest rate and their impact on  
21 the marketable value of the bonds.

22 So we will -- the undertaking is to  
23 provide the split of the 40.6 million between what the  
24 impact of the interest rate is on the market value of  
25 the bonds and the change in coupon rate impact on



1 investment income.

2 MS. CANDACE GRAMMOND: Thank you.

3 With that answer and your clarification that the  
4 offset is actually very small, we're satisfied and so  
5 we don't need you to give us the undertaking to find  
6 the precise number. We just wanted to have a sense of  
7 the amount.

8 Okay. Now, this downward force on  
9 investment income -- so we're still talking about the  
10 offset -- actually continues into subsequent periods,  
11 all other things being equal.

12 Would you agree?

13

14 (BRIEF PAUSE)

15

16 MS. HEATHER REICHERT: Sorry, you're -  
17 - you're -- this -- this -- we're not talking now  
18 about this example? We're just --

19 MS. CANDACE GRAMMOND: We're talking  
20 about the lower coupon rate on the new investments.  
21 So that -- we -- we talked about the fact that the  
22 market value change is isolated to the accounting  
23 period in which the change occurs.

24 Now we're talking about the lower  
25 coupon rate on new investments and that that

1 conversely actually carries forward into subsequent  
2 periods, all other things being equal?

3 MS. HEATHER REICHERT: It will carry  
4 forward as long as we hold that bond.

5 MS. CANDACE GRAMMOND: And as long as  
6 you buy new bonds?

7 MS. HEATHER REICHERT: Correct, in a  
8 declining interest rate environment, and the opposite  
9 being true in an increasing interest rate environment.

10 MS. CANDACE GRAMMOND: Okay. So to  
11 sum all of this up a little bit, we have on the one  
12 hand the market value change, which is a relatively  
13 strong force, in one direction. And then we have the  
14 lower coupon rate on new investments, which is a  
15 relatively weak force, coming in the opposite  
16 direction in the period with the interest rate shift.

17 Agreed?

18 MS. HEATHER REICHERT: Agreed.

19 MS. CANDACE GRAMMOND: See, that was  
20 easy. Now, in subsequent periods the so-called --  
21 what we'll call the opposite direction force, the  
22 lower coupon rate on new investment force, continues  
23 and grows insignificant as more newly purchased bonds  
24 accumulate within the portfolio.

25 Would that be fair to say?

1 MS. HEATHER REICHERT: Again, we're  
2 assuming a continuing declining interest rate  
3 environment going forward. Yes, then that's true.

4 MS. CANDACE GRAMMOND: Just to  
5 clarify, we're considering not necessarily a declining  
6 interest rate environment, but an environment in which  
7 there are lower interest rates? They -- they could  
8 stay the same. They don't necessarily have to  
9 decline.

10 MS. HEATHER REICHERT: Lower interest  
11 rates than the bonds that we're currently holding,  
12 or... I'm sorry -- I'm sorry to be difficult. Yeah,  
13 lower than what?

14 MS. CANDACE GRAMMOND: Sorry, and I --  
15 I apologize for not being clear. We're -- when I say,  
16 "still lower," I'm talking about the fifty (50) basis  
17 point downward shift that's referenced in Table 1.1,  
18 that that continues even if rates do not decline  
19 further?

20

21 (BRIEF PAUSE)

22

23 MS. HEATHER REICHERT: Yes, the impact  
24 goes forward if they go down fifty (50) basis points  
25 and hold and we've got lower coupon rates on our

1 bonds.

2 MS. CANDACE GRAMMOND: Okay. So still  
3 on Table 1.1, moving to the next number, the change in  
4 net claims incurred, again in this fifty (50) basis  
5 point decline environment we see that for the 2013/'14  
6 year there is an increase in net claims incurred of  
7 about 57.9 million, yes?

8 MS. HEATHER REICHERT: Yes.

9 MS. CANDACE GRAMMOND: Now, would you  
10 agree that the decline in interest rate referenced  
11 here would lead to a reduction in the investment  
12 return rate assumed for discounting purposes in  
13 evaluation of the actuarial liabilities leading to an  
14 increase in these balance sheet provisions?

15 MS. HEATHER REICHERT: Yes. Yes.

16 MS. CANDACE GRAMMOND: Would you agree  
17 that the net income resulting from the increase in the  
18 actuarial liabilities comes about because claims  
19 incurred in the income statement is derived as amounts  
20 are paid in the period, plus amounts that are  
21 outstanding at the end of the period less amounts  
22 outstanding at the start of the period?

23 MR. LUKE JOHNSTON: Yes.

24 MS. CANDACE GRAMMOND: Is there any  
25 other --

1 MR. REGIS GOSSELIN: I'm sorry. Would  
2 you mind repeating that for me, please, for my  
3 benefit?

4 MS. CANDACE GRAMMOND: Yeah, sure. So  
5 I asked if -- if Mr. Johnston or Ms. Reichert would  
6 agree that the net income resulting from the increase  
7 in actuarial liabilities comes about because the  
8 claims incurred in the income statement is derived as  
9 amounts are paid in the period, plus amounts that are  
10 outstanding at the end of the period, less amounts  
11 outstanding at the start of the period.

12 And the answer was 'yes'.

13

14 CONTINUED BY MS. CANDACE GRAMMOND:

15 MS. CANDACE GRAMMOND: Now, is there  
16 any other way in which the interest rate shift affects  
17 net claims incurred other than through the change in  
18 the investment return rate discounting assumption?  
19 And I can give you an example, if that would be  
20 helpful.

21 MR. LUKE JOHNSTON: Yeah, there --  
22 there are -- there's a few ways. The yield on non-  
23 marketable bonds. That -- that's the book yield. So  
24 similar to interest rates in general then our new non-  
25 marketable bond purchases have had a lower coupon

1 rate. And we've seen that -- that category decline  
2 over time. So the -- that's a -- that's a fairly big  
3 chunk of -- of our assets that are used -- that are  
4 matched to liabilities.

5 Another -- another example would be if  
6 -- say we change the allocation between the -- the  
7 categories. Bought more corporate bonds. Made a  
8 large purchase of non-marketable bonds. There's been  
9 -- that's a case where there's been no market change  
10 to interest rates at all but because the allocations  
11 have changed my -- my weighed average discount rate  
12 will change. And the -- those -- those are a couple  
13 of examples of how -- how they can be impacted.

14 MS. CANDACE GRAMMOND: Mr. Johnston,  
15 thank you for that. Can you comment on the  
16 directional effect and relative magnitude of the  
17 change in net claims incurred in subsequent periods  
18 from -- from those other forces?

19

20 (BRIEF PAUSE)

21

22 MS. CANDACE GRAMMOND: And we're still  
23 in the fifty (50) basis point change scenario.

24

25 (BRIEF PAUSE)

1 MR. LUKE JOHNSTON: The -- so what we  
2 do in forecasting the discount rate for claims  
3 liabilities is we -- and this is from the -- the new  
4 investment model. We essentially forecast the  
5 allocation of the categories used to calculate the  
6 discount rate at the end of the year along, of course,  
7 with the -- the yield at that time.

8 So I can't think of other ways -- like  
9 other than the, you know, the fifty (50) basis point  
10 change you already took in the discount rate. I -- I  
11 can't think of other ways that it would be -- be  
12 affected going forward.

13 MS. CANDACE GRAMMOND: Okay.

14

15

16 (BRIEF PAUSE)

17

18 MS. CANDACE GRAMMOND: So, Mr.  
19 Johnston, it's your view that the impact is contained  
20 within the period in which the interest rates are  
21 changed and that there's no continuing impact beyond  
22 that period?

23 MR. LUKE JOHNSTON: Yeah, that's --  
24 that's my view. Again, the -- the coupons are not  
25 like a consideration in -- in the discount rate, just

1 the yield -- yield to maturity. So that would be my  
2 understanding.

3 MS. CANDACE GRAMMOND: Okay. So still  
4 looking at Table 1.1, we can see that downward  
5 movement in investment income is arising from an  
6 interest rate increase. Sorry, let me start my  
7 question over again. And then maybe after this one  
8 we'll take a break because it's almost 2:30.

9 So from this table we can see that  
10 downward movement in investment income arising from an  
11 interest rate increase is bigger in magnitude than an  
12 upward movement in an interest -- in investment income  
13 arising from an interest rate decrease. I can repeat  
14 that if you want. The question is: Why is that?

15 So in other words, why do we have in  
16 the first row in the decline scenario a 17.3  
17 million...

18

19 (BRIEF PAUSE)

20

21 MS. CANDACE GRAMMOND: Right. So, in  
22 essence -- oh, sorry.

23

24 (BRIEF PAUSE)

25



1 MR. LUKE JOHNSTON: So I'm -- I'm  
2 told, I -- I would -- first of all, I -- I agree that  
3 they are not identical. But they're definitely quite  
4 similar, claims specifically. Without getting into  
5 what that is, they -- the -- my investment colleague  
6 in the back was mentioning convexity, considerations  
7 such as that that make it slightly different.

8 But -- but I -- I would -- I would say  
9 these are, from my view, basically very, very similar  
10 impacts. I wouldn't -- I wouldn't call them  
11 significantly different.

12

13 (BRIEF PAUSE)

14

15 MS. CANDACE GRAMMOND: Maybe just a  
16 couple more questions, Madam Chairman, just to finish  
17 this train of thought, and then -- if that would  
18 please the Board.

19 So, Mr. Johnston, is it fair then to  
20 conclude that net claims incurred is more interest  
21 rate sensitive than investment income?

22 MR. LUKE JOHNSTON: Yes, the -- well,  
23 a couple notes on that. Right now, the size of the  
24 two (2) categories, fixed income and claim  
25 liabilities, are about the same. So that's one (1) --

1 one (1) important piece.

2                   The duration or the av -- the average  
3 payment date of the liabilities is -- is farther in  
4 the future. It's about nine (9) -- nine (9) years.  
5 At the time this was done, fixed income assets were, I  
6 believe, seven-point-two (7.2).

7                   So if you're discounting, you know, on  
8 average, payments that are farther in the future  
9 you're going to get a bigger effect from interest rate  
10 change. And that's -- that's what you -- that's what  
11 you're seeing here. If -- if the durations were the  
12 same the impact would be minimal or close to -- close  
13 to zero.

14

15                   (BRIEF PAUSE)

16

17                   MS. CANDACE GRAMMOND: Now, is the  
18 inclusion of the non-marketable MUSH bonds in the  
19 investment portfolio also a contributing factor to the  
20 difference in interest rate sensitivity, since the  
21 MUSH bonds are categorized as held to maturity and,  
22 therefore, shown at amortized cost on the balance  
23 sheet?

24

25                   MR. LUKE JOHNSTON: Since we use the  
book yield in the liability discount rate calculation,

1 and -- and that's also how those bonds are held for  
2 accounting purposes, the -- there shouldn't be a  
3 significant effect from that other than the one I  
4 already mentioned, just the long -- you know, the  
5 long-term trend in the yield to maturity of MUSH bonds  
6 has pulled down the -- the liability discount rate.  
7 But for short-term changes that shouldn't be a huge  
8 consideration -- or a significant consideration.

9 MS. CANDACE GRAMMOND: You would agree  
10 though, Mr. Johnston, that the MUSH bonds are not  
11 interest-rate sensitive?

12 MR. LUKE JOHNSTON: I agree and the --  
13 the liability discount rate calculation is also not  
14 affected because the MUSH -- the MUSH bonds are held  
15 at book yield. So sudden changes in market value  
16 wouldn't change the MUSH book yield at all.

17

18 (BRIEF PAUSE)

19

20 MS. CANDACE GRAMMOND: Madam chair, I  
21 just have a couple more questions on this topic but it  
22 will probably take a few minutes, so maybe we could  
23 take the afternoon break now if that would please the  
24 Board?

25 THE CHAIRPERSON: Thank you, Ms.

1 Grammond. Yes, we'll take a break for fifteen (15)  
2 minutes.

3

4 --- Upon recessing at 2:31 p.m.

5 --- Upon resuming at 2:53 p.m.

6

7 THE CHAIRPERSON: Okay. Welcome back.  
8 I think, Ms. Kalinowsky, you've got an undertaking?

9 MS. KATHY KALINOWSKY: Yes. We'd like  
10 to file Undertaking number 10, and it should be marked  
11 as MPI Exhibit number 25. This package is actually  
12 just one (1) undertaking. It -- it has several  
13 reports attached to it, which explains its thickness.  
14 Thank you.

15

16 --- EXHIBIT NO. MPI-25: Response to Undertaking  
17 number 10

18

19 THE CHAIRPERSON: Thank you. Ms.  
20 Grammond, you're going to continue your cross-exam?

21 MS. CANDACE GRAMMOND: Yes. Thank  
22 you, madam chair.

23

24 CONTINUED BY MS. CANDACE GRAMMOND:

25 MS. CANDACE GRAMMOND: So we've been

1 talking about Table 1.1 on page 7 of the investment  
2 income section of the filing, and we see that what's  
3 reflected in that table shows the interest rate  
4 sensitivity for corporate investment income.

5                   Is it correct to assume that the  
6 interest rate sensitivity shown for the net claims  
7 incurred is also corporate?

8                   MR. LUKE JOHNSTON: No, this is just -  
9 - this is just Basic.

10

11                   (BRIEF PAUSE)

12

13                   MR. LUKE JOHNSTON: Just -- maybe just  
14 to improve that answer a little bit. The com -- the  
15 competitive lines do have claim liabilities, much,  
16 much less than Basic has. The -- the liabilities are  
17 also very short in duration. So Extension would have,  
18 say, a reduced deductible policy. Well, that --  
19 interest rate impact on -- on those type of products  
20 is -- is basically zero. Special risk extension does  
21 have some -- some longer tail claims but generally  
22 it's also a very short duration or short-tailed  
23 coverage.

24                   So corporate -- corporate change in net  
25 claims incurred would be bigger than this number but

1 not by a significant amount.

2 MS. CANDACE GRAMMOND: Mr. Johnston,  
3 can you indicate why the table was prepared in that  
4 manner with the -- the change in investment income  
5 being on a corporate basis and the change in net  
6 claims incurred being on a Basic basis?

7 MR. LUKE JOHNSTON: The investment  
8 portfolio is -- is viewed on a corporate basis, and  
9 then later allocated to the lines. On the -- on the  
10 claims incurred side I -- I have no reason to -- to  
11 look at the corporate view. I can put the impact to  
12 Basic, which is what -- what we're looking at in this  
13 Basic Rate Application.

14 MS. HEATHER REICHERT: If I may, it  
15 may -- it may help just to put it into perspective.  
16 If the change in corporate investment income, if we  
17 had changed that to being -- reflecting Basic, the  
18 impact on Basic, essentially we would be taking 85  
19 percent of each of the numbers in the column that  
20 says, "The change in investment income."

21 So what that effectively would do is  
22 just increase the net impact that we're showing here.  
23 So you take 85 percent of forty (40), which is 34  
24 million, less the 57.9 million, and you would have 23  
25 million net impact. Just to give some sense.

1                   So it would only increase the net  
2 impact that would be experienced by MPI with  
3 fluctuations and interest rates 50 percent lower, or  
4 fifty (50) -- or fifty (50) basis points lower or  
5 fifty (50) basis points higher.

6                   MS. CANDACE GRAMMOND: For the future,  
7 would you agree that presenting the information in  
8 that way, Basic across the board, would be preferable?

9                   MS. HEATHER REICHERT: Totally.  
10 Absolutely.

11                   MS. CANDACE GRAMMOND: At this time,  
12 are you in a position to tell us anything about how  
13 the interest rate sensitivity of Basic net income is  
14 expected to change under IF -- IFRS 4 Phase 2 and IFRS  
15 9?

16                   MS. HEATHER REICHERT: At this point  
17 in time, no. We had Deloitte & Touche review the  
18 exposure draft for IFRS 4. It is still an exposure  
19 draft, which means it's not yet a part of the  
20 accounting standards. And the earliest implementation  
21 -- and I may get my years just a little bit wrong, but  
22 my understanding is that the earliest implementations  
23 would be for years beginning on or after January 1st,  
24 2017.

25                   If that were the case, the very first

1 year that it would have any impact to MPI would be for  
2 the year ended February 2018. Seeing as we haven't  
3 even yet reached the 2014 year end, it is -- it is out  
4 in the future. Because it is still an exposure draft,  
5 there are still potential changes that could be made  
6 to that standard, as well as interpretations put to  
7 what is currently in the standard.

8                   So when you have the opportunity to  
9 read, as I'm sure you will want to read, the IFRS 4  
10 report from Deloitte & Touche, it very much is couched  
11 in a lot of caveats of being subject to  
12 interpretations that may in fact change or standards  
13 that may in fact change once this actually becomes a  
14 final -- a final accounting standard under  
15 international financial reporting.

16

17                   (BRIEF PAUSE)

18

19                   MS. CANDACE GRAMMOND: Thank you.  
20 Now, Ms. Reichert, from the earlier evidence that's  
21 been given in this proceeding, I understand that the  
22 duration of the bond portfolio is strategically  
23 matched so as to take advant -- let me start over with  
24 that question.

25                   I understand that the duration of the



1 bond portfolio is strategically managed so as to take  
2 advantage of any duration mismatch with the actuarial  
3 liabilities. For example, in an environment with  
4 rising interest rates, having the bond portfolio  
5 duration shorter creates more potential upside -- or  
6 more upside potential for net income.

7 Would you agree?

8 MS. HEATHER REICHERT: I agree with  
9 your last statement that having bond duration shorter  
10 in an increasing interest rate environment is ben --  
11 beneficial to the Corporation.

12 MS. CANDACE GRAMMOND: So do you agree  
13 with the first part of the statement, or the first  
14 part of my question, that the duration of the  
15 Corporation's bond portfolio is man -- strategically  
16 managed so as to take advantage of any duration  
17 mismatch with the actuarial liabilities?

18 MS. HEATHER REICHERT: We continue to  
19 forecast that the duration mismatch, if you will,  
20 between our assets and our liabilities remained at the  
21 one point eight (1.8) year span, because that is what  
22 it has been over -- on average over several years.  
23 And we did that, yes, strategically to take advantage  
24 of the fact that in the increasing interest rate  
25 environment that is being forecasted by all of the

1 banks, and including ourselves in our -- in our base  
2 forecast, having that -- that mismatch of one point  
3 eight (1.8) years is a larger benefit to the  
4 Corporation. When interest rates were decreasing over  
5 the past five (5) years or so, we had that same  
6 mismatch. And it hurt the Corporation significantly,  
7 because the opposite was happening. It -- it was a --  
8 a net negative impact to the Corporation.

9           So now, as interest rates are starting  
10 to increase, we wanted to -- to recoup some of what we  
11 had lost over the last five (5) years when interest  
12 rates, in fact, were dropping. So we, from that  
13 perspective, we did keep the mismatch at the one-  
14 point-eight (1.8) years as being more favourable to  
15 the financial results of the Corporation.

16           MS. CANDACE GRAMMOND: Now, is the  
17 strategy that you've just described reflected in the  
18 investment policy statement of the Corporation?

19           MS. HEATHER REICHERT: Within the  
20 investment policy of the Corporation, we are required  
21 to keep the duration of the bonds within two (2) --  
22 plus or minus two (2) years of the liabilities. So it  
23 is within the investment policy statement.

24           MS. CANDACE GRAMMOND: And can you  
25 tell us who is charged with the responsibility for

1 making recommendations under this strategy?

2 MS. HEATHER REICHERT: Sorry. And  
3 what do you mean by the 'strategy'? The fact that we  
4 were forecasting to keep the one point eight (1.8)  
5 band width that has been incurred in the last five (5)  
6 years going forward in our forecast?

7 MS. CANDACE GRAMMOND: Yes.

8 MS. HEATHER REICHERT: That is,  
9 overall, part of the in -- the forecasting exercise  
10 that we go through. We looked at what had been the  
11 band width and what we expected the band width to  
12 continue to be going forward. So that was discussed  
13 at the ICWG (phonetic) and discussed amongst the staff  
14 internally at MPI as we were doing the forecast.

15 MS. MARILYN MCLAREN: This may be a  
16 little bit more context on that. We really don't have  
17 any influence over the duration of the liabilities.  
18 And so discussing the duration of the bond port -- is  
19 -- the bond portfolio certainly does take place at the  
20 SCWG (phonetic). We've never had as discreet  
21 conversation about it internally to MPI as we have  
22 this year with the ability to make so many different  
23 assumptions with the model.

24 You know, with -- with hindsight we  
25 probably -- we certainly did consult with Mr. Gibson

1 with respect his comfort level with that assumption,  
2 as with the bond portfolio turnover. Those would be  
3 the key assumptions that -- that were highlighted for  
4 him. It -- it was probably not as pointed  
5 conversation that we probably will evolve to through  
6 time. It was more, Does this seem reasonable, as  
7 opposed to, Is this something you are prepared to live  
8 with. But it really come -- came out of the  
9 Corporation's forecasting process, the Corporation's  
10 operational needs, and was vetted to an extent with  
11 the bond manager.

12 MS. CANDACE GRAMMOND: Is it fair to  
13 say that the -- the strategy that we've been  
14 describing and the approach that the Corporation is  
15 taking this year is different from the philosophy that  
16 we've discussed in previous years, where the  
17 Corporation sought to immunize net income from  
18 interest rate shifts?

19 MS. HEATHER REICHERT: No, I -- I  
20 would not say that what we are doing this year is  
21 different than what we were doing in past years. In  
22 past years we believed that keeping the asset duration  
23 and the claims liability duration within the two (2)  
24 year, plus or minus, band width was effectively  
25 sufficient immunization to the Corporation against the

1 -- the impact of changing interest rates. And we  
2 never included that in our financial model forecast.  
3 We assumed that they would be very closely immunizing  
4 one another, or offsetting one another.

5                   With the onset of this new financial  
6 model, and with watching what had happened with the  
7 changes in interest rates and the actual net impact to  
8 the overall financial position of the Corporation, we  
9 now are much more sensitive to the fact that in the  
10 increasing interest rate environment that is being  
11 forecasted by all of the banks, and including  
12 ourselves in our -- in our base forecast, having that  
13 -- that mismatch of one point eight (1.8) years is a  
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9 assumptions with the model.

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12 with respect his comfort level with that assumption,  
13 as with the bond portfolio turnover. Those would be  
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16 conversation that we probably will evolve to through  
17 time. It was more, Does this seem reasonable, as  
18 opposed to, Is this something you are prepared to live  
19 with. But it really come -- came out of the  
20 Corporation's forecasting process, the Corporation's  
21 operational needs, and was vetted to an extent with  
22 the bond manager.

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14 We assumed that they would be very closely immunizing  
15 one another, or offsetting one another.

16 With the onset of this new financial  
17 model, and with watching what had happened with the  
18 changes in interest rates and the actual net impact to  
19 the overall financial position of the Corporation, we  
20 now are much more sensitive to the fact that wider  
21 duration in this type of environment is more  
22 beneficial than a smaller duration.

23 So we always were wanting to immunize  
24 our self against the changing interest rates. Now we  
25 can do it on a much more sophisticated and factual



1 basis with the financial model that we have.

2 MS. MARILYN MCLAREN: So was -- was  
3 your question intended to ask: Are we -- we, through  
4 the ICWG, through the -- with the Department of  
5 Finance, managing the investments differently in this  
6 regard this year? Is there a change to our investment  
7 practice, investment behaviour? Is that what you're  
8 asking?

9 MS. CANDACE GRAMMOND: Well, I -- I  
10 think what we're asking is: Has there been a change  
11 in the duration matching philosophy. I mean, in  
12 previous years, we've talked about the immunization  
13 strategy, the 88 percent. This year, the  
14 Corporation's coming forward and saying: We have a  
15 mismatch. We know we have a mismatch; it's on purpose  
16 and we think it's going to help us.

17 So that's what we're trying to  
18 understand, is whether there's been a change in the  
19 thinking.

20 MS. MARILYN MCLAREN: No, we -- we  
21 don't have a different philosophy or approach. We  
22 have better information. We've always said we're  
23 pretty much matched. We're mostly matched, and that  
24 continues to be true. When you're talking about the  
25 scope of our liabilities and our investments, we are

1 80 percent matched. We're -- we are quite highly  
2 matched.

3                   The impact of the mismatch, I remember  
4 last year Mr. Johnston talking about this, the impact  
5 of the mismatch on our income statement is -- can --  
6 can be significant. And with hindsight, we learned  
7 that that mismatched has cost us fair bu -- bit  
8 through time, but it was largely masked with all the  
9 other, you know, reductions of our -- reductions in  
10 reserves in IBNR, the releases that we've had over  
11 time.

12                   So we understand more. We have better  
13 information. It just -- the only, I guess, decision  
14 we -- we -- given the way things transpired over the  
15 last few years in the decreasing interest rates, with  
16 20/20 hindsight, I wouldn't suggest that if we had  
17 known what was going to happen we would have done  
18 anything differently at that point, so I don't see it  
19 as a change.

20                   We -- we understand better. We know  
21 better. And at this point, we continue to be  
22 comfortable with about the same level of matching that  
23 we have and are able to tell you what the impact of  
24 that would be.

25                   MS. CANDACE GRAMMOND:     So when -- Ms.

1 McLaren, when you talk about being at relatively the  
2 same level of matching, you're talking about the 80  
3 percent now compared with the 88 percent, I think it  
4 was, in the last couple of years?

5 MS. MARILYN MCLAREN: Right.

6 MS. CANDACE GRAMMOND: So here's --  
7 here's our next question. We've heard from the  
8 Corporation in connection with its change in interest  
9 rate forecasting that it's concerned about over  
10 forecasting, upward movement in interest rates.

11 In that context, we -- we want to  
12 understand why the -- and -- and in -- I understand  
13 your comments, that the strategy hasn't changed, but  
14 the overall matching has decreased from about eighty-  
15 eight (88) to eighty (80).

16 So can you comment on that in -- in the  
17 context of the worry, I guess, about over-forecasting  
18 on the interest rates because they -- they seem to be  
19 incongruous?

20 MS. MARILYN MCLAREN: Well, there's a  
21 cost to perfectly matching at this point, right. If -  
22 - if we were to just, you know, ask the bond manager  
23 to, you know, reconstruct the portfolio to a hundred  
24 percent match, that -- we probably, through time,  
25 would either need bigger rate increases or we would

1 not have the excess money that -- or in those outer  
2 years right now.

3                   So we're not -- and I guess I'm not  
4 saying that we're here taking a hard, hard position  
5 that we think we always will continue to be mismatched  
6 to a certain extent. You know, I mean, this is -- it  
7 is uncertain times. The Application that we put  
8 forward is the best that we've been able to put  
9 together to reflect our view of appropriate risk  
10 mitigation in uncertain times. So that's really what  
11 I would say about that.

12                   I mean, I think the jury is out. We  
13 will continue to think about -- because as -- as Ms.  
14 Reichert has said, if, you know, you continue to have  
15 the volatility, even if it's trending upwards, but it  
16 is volatile, like it has been for the last three (3)  
17 years, there -- there is a hit associated with that,  
18 and it may very well be to the funds stability  
19 objectives to just cut to the chase and match. But  
20 there will be a cost associated.

21                   We're -- we're learning. We're  
22 watching. We're proceeding. But right now this is  
23 our best Application, best forecast.

24                   MS. CANDACE GRAMMOND: Has the  
25 Corporation modelled the impact on investment returns

1 and net income based on a perfect match scenario?

2

3 (BRIEF PAUSE)

4

5 MS. HEATHER REICHERT: Yes, we have  
6 modelled a perfect match scenario. We are just  
7 finalizing filing -- finalizing that scenario so that  
8 we would be able to share that with -- with the Board  
9 in -- at some point this week.

10 MS. CANDACE GRAMMOND: We'll take that  
11 undertaking.

12 MS. HEATHER REICHERT: Or -- or maybe  
13 some -- sometime this week or very early next week.

14

15 --- UNDERTAKING NO. 24: MPI to provide the model  
16 of the impact on  
17 investment returns and net  
18 income based on a perfect  
19 match scenario

20

21 (BRIEF PAUSE)

22

23 CONTINUED BY MS. CANDACE GRAMMOND:

24 MS. CANDACE GRAMMOND: Can you comment  
25 on how the Corporation was able to run that scenario,

1 the 100 percent match scenario, in light of the  
2 content of the MUSH bonds within the portfolio?

3 MR. LUKE JOHNSTON: The -- to get the  
4 overall fixed income duration to be, say, nine (9) for  
5 example, you do have to increase the marketable bond  
6 duration substantially to get an overall average of  
7 nine (9).

8 So it's not that you just -- you know,  
9 you -- you if -- if you're 25, 30 percent weighed in  
10 non-marketables and they have a duration of six (6),  
11 you got -- you're going to have to increase the  
12 marketable bond duration quite a bit to get an average  
13 of nine (9).

14

15 (BRIEF PAUSE)

16

17 MS. CANDACE GRAMMOND: So, Mr.  
18 Johnston, are you saying that while under this  
19 scenario the mat -- the durations are matched, it does  
20 not equate to 100 percent immunization?

21

22 (BRIEF PAUSE)

23

24 MR. LUKE JOHNSTON: So I'm not sure  
25 that is what I was saying, and -- but there's -- right

1 now if you look at the fixed income portfolio, or  
2 rather -- I'm probably better quoting what was done in  
3 the Rate App.

4                   But say the duration is seven point two  
5 (7.2), and -- and the marketable bonds have a duration  
6 of nine (9), and the -- and the MUSH have a duration  
7 of six (6). You might have to increase marketable  
8 bond duration to twelve (12) or thirteen (13), or --  
9 or some -- maybe eleven (11) or twelve (12) to get  
10 that nine (9) average.

11                   Your durations would then be matched.  
12 You'll have better immunization. So that -- that was  
13 my point. I think you're asking a different question  
14 now. Maybe you can repeat that one for me.

15                   MS. CANDACE GRAMMOND: So it will be  
16 better immunized, even though not perfectly immunized,  
17 though the durations will be matched.

18                   MR. LUKE JOHNSTON: There's -- there's  
19 a few -- there's other reasons why Basic insurance  
20 wouldn't be perfectly immunized, the -- the main one  
21 being that it's a corporate duration matching  
22 strategy.

23                   Basic claims do have a longer duration  
24 than -- than corporate claims, longer than -- than  
25 nine (9) at -- at -- as of the end of last year. So

1 that would be one -- one main reason why they wouldn't  
2 be 100 percent immunized for this line of business.

3

4 (BRIEF PAUSE)

5

6 MS. CANDACE GRAMMOND: Thank you.

7 Moving then into interest rate forecasting. If we --  
8 we were at page 7 of the investment income section.  
9 We spent quite a bit of time on Table 1.1. I'm going  
10 to ask you to turn the page to page 8, where we find  
11 Chart 1.2. So page 8 of the investment income  
12 section, Chart 1.2. Now, within this chart the GRA  
13 assumed interest rate forecast for ten (10) year  
14 Government of Canada bonds is represented with the  
15 black boxes -- or the black squares.

16 Is that right?

17 MS. HEATHER REICHERT: That is  
18 correct. The -- the underlying interest rate forecast  
19 to our Application is denoted by the line with the  
20 black boxes.

21 MS. CANDACE GRAMMOND: And we see a  
22 gradual increase from an actual value of about 1.9  
23 percent at February 2013, increasing to about 2.1  
24 percent at February '14.

25 Are you with me so far?



1 MS. HEATHER REICHERT: I -- I can give  
2 you the exacts, if you'd like, as opposed to reading  
3 them off of the graph.

4 MS. CANDACE GRAMMOND: Sure.

5 MS. HEATHER REICHERT: So we start at  
6 an actual of one point eight-seven (1.87) at the  
7 beginning of this current fiscal year. Then go at the  
8 end of this fiscal year to 2 percent. At the end of  
9 2014/'15, 2.32 percent. At the end of 2015/'16, to  
10 2.67 percent; '16/'17, 3.21 percent; and then '17/'18,  
11 3.86 percent.

12 MS. CANDACE GRAMMOND: Thank you.  
13 Focussing on the difference from February of 2013 to  
14 February of 2016 -- so if I heard you correctly  
15 February of 2013 was one point eight-seven (1.87),  
16 February of 2016 was two point six-seven (2.67).

17 So an increase of about eighty (80)  
18 basis points over three (3) years?

19 MS. HEATHER REICHERT: That is  
20 correct.

21 MS. CANDACE GRAMMOND: Now, the GRA  
22 interest rate forecast is based on what is called the  
23 'lower interest rate growth approach', which I  
24 understand spreads over a ten (10) year period the  
25 growth expected over five (5) years from the

1 Corporation's standard interest rate forecast. So  
2 effectively cutting the rate in -- rate growth in  
3 half.

4 Is that right?

5 MS. HEATHER REICHERT: Right.

6 Extending the -- the growth over a -- twice as long,  
7 yes.

8 MS. CANDACE GRAMMOND: Is it fair to  
9 say that the objective of the lower interest rate  
10 growth approach is to address the apparent persistent  
11 optimism of the bank and Global Insight interest rate  
12 forecasts as depicted in Chart 1.2?

13 MS. HEATHER REICHERT: That is  
14 correct.

15 MS. CANDACE GRAMMOND: Can you tell us  
16 whether this decision to reduce the standard interest  
17 rate forecast by one-half (1/2) was based on any  
18 particular analysis or whether it was selected through  
19 judgment?

20 MS. HEATHER REICHERT: It was selected  
21 through judgment.

22 MS. CANDACE GRAMMOND: So how did you  
23 conclude that this amount of scaling back was  
24 consistent with preparing a best-estimate forecast?

25 MS. MARILYN MCLAREN: Not to put too

1 fine a point on it, but we couldn't find any best-  
2 estimate forecasts, not looking at that graph. I -- I  
3 think I mentioned in my direct at the beginning, I  
4 mean, we were really astounded when we looked at the  
5 actual history when we put this together. So we felt  
6 -- and, again, as I said, you know, if -- if we had  
7 stuck with that blue line, doing what we had always  
8 done before, we wouldn't be here asking for a rate  
9 increase.

10                   And we really felt it was absolutely  
11 incumbent on us to find some way to mitigate this  
12 persistent over-optimism. And so if -- if there's  
13 some guideline somewhere that says best estimates  
14 can't be judgment, management judgment, then I guess  
15 it's not a best estimate. But this was incredibly  
16 long, detailed conversation, discussion, analysis,  
17 absolutely, as what if we do this, what if we do that.  
18 So there was many, many scenarios run. So that would  
19 be the analysis that we did. And at the end of the  
20 day we believe this is our best estimate which  
21 mitigates the significantly overly optimistic history.

22                   MS. CANDACE GRAMMOND: Thank you.  
23 Now, I understand that the GRA interest rate forecast  
24 uses the lower interest rate growth forecast for the  
25 first three (3) years, to February of 2016, and then

1 the Conference Board of Canada forecast thereafter.

2 Is that right?

3 MS. HEATHER REICHERT: Yes, it is.

4 MS. CANDACE GRAMMOND: Is it fair to  
5 say that the Conference Board forecast is pessimistic  
6 relative to the bank and global insight forecasts, and  
7 even relative to the lower interest rate growth  
8 forecast over the first three (3) years?

9 MS. HEATHER REICHERT: That is  
10 correct.

11 MS. CANDACE GRAMMOND: Did the  
12 Corporation undertake any back-testing to see if the  
13 corporate -- Conference Board of Canada forecasts have  
14 been persistently pessimistic in the recent past,  
15 particularly beyond three (3) years?

16 MS. HEATHER REICHERT: No, I would say  
17 we didn't do that.

18 MS. CANDACE GRAMMOND: So is the  
19 Corporation satisfied that the Conference Board  
20 forecasts represent a best estimate beyond February of  
21 2016?

22 MS. HEATHER REICHERT: Again,  
23 following on what Ms. McLaren said, we used our  
24 judgment to choose a scenario of interest rate  
25 forecasts that would mitigate the impact of continuing

1 in the way we've always done it, which was the blue  
2 line, or taking a -- an absolute pessimistic view of  
3 the future or absolute lowest possible forecast of the  
4 future by -- by taking only -- well, sorry, by taking  
5 the Conference Board of Canada in the first three (3)  
6 years and then the lower interest rate in the  
7 following two (2).

8           So the judgment was to take a middle of  
9 the road interest rate forecast in order to mitigate  
10 the impact of assuming increasing -- high increasing  
11 interest rates throughout the period and also not  
12 assuming too low of an interest rate by taking the low  
13 forecast throughout that five (5) year period.

14           So it really was a balance to come up  
15 with what we deemed to be a -- a best estimate for the  
16 GRA.

17           MS. MARILYN MCLAREN: Right. And in  
18 addition to that I would say that, you know, it's  
19 really important to note that after the three (3)  
20 years there was no impact on the rates that we are  
21 applying for here today in this application. It is  
22 well outside the rating period after the three (3)  
23 years.

24           I would also say that, you know, just  
25 another way to say what Ms. Reichert said, is that it

1 wasn't -- it really wasn't about the Conference Board  
2 at that point in terms of the fourth year and the  
3 fifth year. It was not being uncomfortable with the  
4 slope of that line basically reflecting the slope of  
5 the five (5) banks that they've, you know, they've  
6 missed through time.

7                   But the way we have mitigated the  
8 optimism in the first three (3) years we were not  
9 uncomfortable, for the sake of modelling this, given  
10 that it's outside the rating period, to return to the  
11 slope, but at a much lower level.

12                   MS. CANDACE GRAMMOND: Thank you.

13 Now, I understand that the yield on ten (10) year  
14 Government of Canada bonds is just over 2.6 percent as  
15 of the end of August 2013.

16                   Would you accept that?

17

18                   (BRIEF PAUSE)

19

20                   MS. HEATHER REICHERT: 2.616 percent  
21 to be exact.

22                   MS. CANDACE GRAMMOND: Thank you for  
23 that precision. Would -- would you agree -- oh, now he's  
24 making an actuary versus accountant joke which I  
25 shan't repeat. Ms. Reichert, you would agree that

1 that's up by about seventy (70) basis points over the  
2 last six (6) months, since February of 2013?

3 MS. HEATHER REICHERT: Approximately,  
4 yes.

5 MS. CANDACE GRAMMOND: Whereas the GRA  
6 assumption in comparison is in -- of an eighty (80)  
7 point -- basis point increase over three (3) years.

8 Is that right?

9 MS. HEATHER REICHERT: That is  
10 correct.

11 MS. CANDACE GRAMMOND: Now, based on  
12 our earlier discussions, is it fair to say that most  
13 of this beneficial effect on Basic net income will be  
14 observed in the results of the current year for  
15 2013/'14?

16 MS. HEATHER REICHERT: Yes, that --  
17 that is correct. Most of it will be seen in the  
18 current fiscal year, again depending on what happens  
19 between now and the end of the year with interest  
20 rates. But if these were to hold, then most of this  
21 bene -- well, all of this benefit would be seen in --  
22 in the '13/'14 fiscal year.

23

24

(BRIEF PAUSE)

25

1 MS. CANDACE GRAMMOND: And to the  
2 extent that net income goes up, the Basic net income  
3 goes up. Basic retained earnings also go up by the  
4 same amount?

5 MS. HEATHER REICHERT: With respect to  
6 that particular aspect? Yes.

7 MS. CANDACE GRAMMOND: So if fifty  
8 (50) basis points of upward movement in interest rates  
9 is worth about \$22 million, as we saw earlier...

10

11 (BRIEF PAUSE)

12

13 MS. CANDACE GRAMMOND: Just a moment,  
14 Madam Chair.

15

16 (BRIEF PAUSE)

17

18 MS. CANDACE GRAMMOND: Thank you, Ms.  
19 Reichert. I think we've been doing the same math at  
20 our respective tables. And, of course, I'm referring  
21 to the royal 'we', Mr. Pelly and myself. So going  
22 back just for a moment to Table 1.1. We had a  
23 discussion earlier in the evidence about a change to  
24 the net impact column.

25

Can you tell us, based on those



1 changes, what the net inco -- or the net impact rather  
2 of 22.4 million becomes if we make the -- the table  
3 purely relative to Basic?

4 MS. HEATHER REICHERT: My calculation  
5 is it becomes about twenty-seven point seven (27.7)  
6 favourable.

7 MS. CANDACE GRAMMOND: Thank you. And  
8 ours is the same. So with that, say, \$27.7 million  
9 number in Table 1.1, if that is the net impact of a  
10 fifty (50) basis point of upward movement in interest  
11 rates, then would we expect the actual seventy (70)  
12 basis point upward movement so far in the current  
13 fiscal year to contribute to about \$38.8 million of  
14 Basic net income?

15 MS. HEATHER REICHERT: I am told by  
16 people a lot smarter than I am that it's not entirely  
17 linear, so it would be more than twenty-seven point  
18 seven (27.7), but it's not proportionately more than  
19 twenty-seven point seven (27.7).

20 Am I correct?

21

22 (BRIEF PAUSE)

23

24 MS. HEATHER REICHERT: Okay, so I am  
25 told that if you were to do it proportionately you

1 would come up with 39 -- 39 million impact. And it  
2 would not exactly be 39, it would be something less  
3 than that, but it would be close thereto, I'm told.

4 MS. CANDACE GRAMMOND: Thank you.  
5 Okay, I'm going to ask you then to go to PUB/MPI Pre-  
6 ask 2. And I'll give you the exhibit number.

7

8 (BRIEF PAUSE)

9

10 MS. CANDACE GRAMMOND: So this is MPI  
11 Exhibit 1 dash -- pardon me, Exhibit 11-2. We entered  
12 all of the Board pre-asks as Exhibit 11, and then with  
13 sub-exhibit numbers. So this is PUB/MPI Pre-ask 2,  
14 Exhibit 11-2. And I'll wait to ensure that the panel  
15 has those pre-asks in front of it.

16

17 (BRIEF PAUSE)

18

19 MS. CANDACE GRAMMOND: Okay. So if  
20 everyone has that exhibit I will ask you to go the  
21 table in response to (b), which is on page 2. So in  
22 essence the bottom half of page 2.

23 This table, as I understand it, shows  
24 various bank forecasts and the global insight forecast  
25 updated to reflect the most recent information

1 available at the time of the response, which was last  
2 week.

3 Is that right?

4 MS. HEATHER REICHERT: Yes, that's  
5 correct.

6 MS. CANDACE GRAMMOND: And any of the  
7 bank forecasts that were prepared on an end-of-period  
8 basis were adjusted and shown in this table on an  
9 average period basis?

10 MS. HEATHER REICHERT: That's correct.

11 MS. CANDACE GRAMMOND: Does the  
12 Corporation have any concerns with respect to this  
13 adjustment to a consistent average period basis?

14 MS. HEATHER REICHERT: No, not overly.  
15 We -- we don't have any concerns.

16 MS. CANDACE GRAMMOND: Now, it's been  
17 mentioned earlier in this hearing that the Public  
18 Utilities Board has adopted an approach to the  
19 selection of interest rate forecasts for another  
20 utility that addresses the risk of optimism in the  
21 bank forecast by using the median forecast after  
22 eliminating the highest forecast value in each  
23 forecast period.

24 I understand that the last column in  
25 this particular table, that is the bottom table on

1 page 2, has been prepared on this basis, at least to  
2 the end of 2014?

3 MS. HEATHER REICHERT: Yes, that's  
4 correct.

5 MS. CANDACE GRAMMOND: And beyond 2014  
6 the last column reproduces the Global Insight ,which  
7 is the only forecast available beyond 2014 from those  
8 sources.

9 MS. HEATHER REICHERT: Correct.

10 MS. CANDACE GRAMMOND: Would you agree  
11 with the observation that the global insight forecast  
12 for Quarter 4 of 2014 is the second lowest from among  
13 the six (6) forecasts shown?

14 MS. HEATHER REICHERT: Yes, I would  
15 agree.

16 MS. CANDACE GRAMMOND: And that's of  
17 course the 3.01 percent? Now, still within this pre-  
18 ask, I would ask you to turn to the second-last page.

19

20 (BRIEF PAUSE)

21

22 MS. CANDACE GRAMMOND: So it's  
23 labelled in the right-hand -- upper right-hand corner,  
24 "PUB/MPI Pre-ask 2C Part 2," and it's numbered page 5.

25 MS. HEATHER REICHERT: I have it.

1 MS. CANDACE GRAMMOND: Okay. Does the  
2 Board have it? So page 5, which is the second-last  
3 page of this document.

4

5 (BRIEF PAUSE)

6

7 MS. CANDACE GRAMMOND: Thank you.  
8 Now, can you confirm that this particular document  
9 shows the pro forma income statement forecasts  
10 reflecting the interest rate forecast that we were  
11 just discussing in combination with a 1.8 percent  
12 overall rate increase taking effect March 1st, 2014?

13 MS. HEATHER REICHERT: Yes, I can.

14 MS. CANDACE GRAMMOND: Thank you.  
15 Now, looking to the bottom line of this exhibit, the  
16 net income or loss line from operations, we see a  
17 positive net income of just under 1.6 million in  
18 2014/'15, and about 6.7 million in 2015/'16. And  
19 those items of net income follow a net income of just  
20 under 50 million in the current year.

21 Is that right?

22 MS. HEATHER REICHERT: Yes, it is.

23 MS. CANDACE GRAMMOND: And based on  
24 the Corporation's approach that we've talked about in  
25 terms of how it calculates a breakeven, would the same

1 rate increase still be applied for under this  
2 forecast?

3 MS. HEATHER REICHERT: Given in this  
4 situation that the average is 4 -- 4 million average  
5 of the two (2) rating years. It -- it's debatable.  
6 That's about a half a percent. So it might -- if this  
7 were our forecast, it might have reduced the one point  
8 eight (1.8) down a half -- a half a point to one point  
9 three (1.3).

10 MS. CANDACE GRAMMOND: Thank you. So  
11 I'm going to ask you then to turn the page to page 6  
12 of the same document. So just flip -- flip the page.  
13 This is a recast of PF-3, which is a retained earning  
14 schedule for Basic. And if we look at this, again, in  
15 the scenario that we've been discussing, we see the  
16 Basic retained earnings exceeding 190 million by the  
17 end of 2013/'14 and growing thereafter.

18 Is that right?

19 MS. HEATHER REICHERT: Sorry, did you  
20 say 180 million by the end of --

21 MS. CANDACE GRAMMOND: I -- I said  
22 exceed 190 million -- or I meant to say it; maybe I  
23 didn't -- exceed 190 million by the end of the current  
24 fiscal year and then increase thereafter. If I'm  
25 looking at the one ninety-one, o-four-two (191,042).

1 MS. HEATHER REICHERT: Oh, okay.

2 Sorry, yes, I -- I see that number now.

3 MS. CANDACE GRAMMOND: Thank you.

4 Now, I apologize for jumping around, but it's  
5 necessary. I'm now going to ask you to go back to  
6 page 3, so same document, but let's leave page 6 and  
7 go back to page 3. This is a recast of PF-1, pro  
8 forma 1, in the scenario of a 1 percent rate increase.  
9 And the forecasts, in terms of net results, are  
10 similar to what we just reviewed.

11 Is that right?

12 MS. HEATHER REICHERT: Yes, I believe  
13 so.

14 MS. CANDACE GRAMMOND: Again, we see  
15 in current year net income of just under 50 million  
16 ;for the year of the Application, we see a net loss of  
17 just under 1.7 million; and then we see net income for  
18 2015/'16 of four hundred and twenty-seven thousand  
19 (427,000).

20 Is that right?

21

22 (BRIEF PAUSE)

23

24 MS. HEATHER REICHERT: I'm sorry, Ms.

25 Grammond, can you just repeat that?

1 MS. CANDACE GRAMMOND: Sure. So I'm  
2 on page 3.

3 MS. HEATHER REICHERT: Yep.

4 MS. CANDACE GRAMMOND: And this is the  
5 scenario that includes a 1 percent rate increase as  
6 opposed to what the Corporation has applied for. So  
7 we see for the current year, 20 -- ending in 2014 a  
8 net income of just under 50 million, forty-nine, five-  
9 seven-three (49,573).

10 MS. HEATHER REICHERT: I'm not on the  
11 right page then.

12

13 (BRIEF PAUSE)

14

15 MS. HEATHER REICHERT: Yes, I can see  
16 it.

17 MS. CANDACE GRAMMOND: Okay. So we're  
18 -- we're in Pre-ask 2, page 3. Is that what you have  
19 in front of you?

20 MS. HEATHER REICHERT: Yes, the  
21 electronic version that I'm looking at has what you're  
22 referring to.

23 MS. CANDACE GRAMMOND: Okay.

24 MS. HEATHER REICHERT: I think I just  
25 have a -- a photocopy issue.



1 MS. CANDACE GRAMMOND: Okay. So this  
2 is in the scenario we see in the top left-hand corner,  
3 "PF-1, 1 percent, Part B," just to make sure that  
4 we're looking at the same thing?

5 MS. HEATHER REICHERT: Yes.

6 MS. CANDACE GRAMMOND: So we see --  
7 just to -- so that we're clear, so current year ending  
8 2014, this -- in this scenario forecasts a net income  
9 of just under 50 million. In the year of the  
10 Application we see a net loss of just under 1.7  
11 million. And then for 2015/'16 we see a net income of  
12 four hundred and twenty-seven thousand (427,000)?

13 MS. HEATHER REICHERT: Correct.

14 MS. CANDACE GRAMMOND: Okay. Now,  
15 based on the Corporation's regular approach to  
16 breaking even and how that's calculated, would you say  
17 that a 1 percent overall rate level increase is  
18 justified under this forecast?

19 MS. HEATHER REICHERT: Generally  
20 speaking, yes.

21 MS. CANDACE GRAMMOND: Thank you. I'm  
22 going to ask you, then, to move to Pre-ask 3. So it's  
23 still part of Exhibit 11, MPI Exhibit 11, but now it's  
24 11-3, rather than 11-2.

25

1 (BRIEF PAUSE)

2

3 MS. CANDACE GRAMMOND: Does everyone  
4 have Pre-ask 3? Okay. So would you agree that what  
5 we see here -- and this is only a two (2) page  
6 document, double-sided.

7 Would you agree that this is a summary  
8 of various forecasted amounts under each of a number  
9 of different interest rate change and rate level  
10 change scenarios that have been requested by the Board  
11 through the IR and pre-ask process?

12 MS. HEATHER REICHERT: Yes, I would.

13 MS. CANDACE GRAMMOND: And is it fair  
14 to say that the different interest rate forecasts  
15 underlying these scenarios, like the interest rate  
16 forecast that's underlying the GRA, each represents a  
17 distinct possible in -- outcome for Basic, but that  
18 all of the scenarios are not equally likely?

19 MS. HEATHER REICHERT: Yes, I can  
20 agree with that.

21 MS. CANDACE GRAMMOND: Now, I note  
22 that the forecasted levels of Basic net income for the  
23 year of the application, 2014/'15, range from a low of  
24 \$21.5 million loss to -- and that's at 3B -- to a high  
25 of \$10.1 million income. That's at 2A on -- or under

1 4B, but at 2A on the second page, compared with the  
2 GRA forecast of 7.5 million.

3 Can you tell me -- and -- and if you  
4 want to take this as an undertaking, that's fine --  
5 are there any scenarios on this list which the  
6 Corporation would be con -- would consider to be  
7 extreme outliers?

8

9 (BRIEF PAUSE)

10

11 MS. HEATHER REICHERT: We can take  
12 that as an undertaking.

13 MS. CANDACE GRAMMOND: And the second  
14 part of that, so which scenarios in this document  
15 would it consider to be extreme outliers, if any? And  
16 if the Corporation does so identify an extreme outlier  
17 or more than one (1), why?

18 MS. HEATHER REICHERT: Yes, we will.

19

20 --- UNDERTAKING NO. 25: MPI to advise which  
21 scenarios under 2A the  
22 Corporation would consider  
23 to be extreme outliers and  
24 why

25

1 MS. HEATHER REICHERT: I would just  
2 like -- while we -- we are looking at this summary, I  
3 think it -- it really displays what we have been  
4 discussing over the last several days, and quite a bit  
5 today. This shows how much volatility there is in the  
6 results of the Corporation depending on what, in fact,  
7 does happen with interest rates, because all of these  
8 different scenarios are assuming different growths or  
9 different interest rates for the rating period. So  
10 you can see from what Ms. Grammond already  
11 highlighted, the impact can be quite significant to  
12 the Corporation depending on what happens with  
13 interest rates. So this, I think, just highlights  
14 that very, very well.

15

16 CONTINUED BY MS. CANDACE GRAMMOND:

17 MS. CANDACE GRAMMOND: Thank you.  
18 Would you agree that the accuracy of Basic net income  
19 forecasting could be improved if Basic net income  
20 could be made less interest rate sensitive?

21 MS. HEATHER REICHERT: I'm hesitating.  
22 I think that the volatility of the Basic income  
23 forecast would -- it would be less volatile if the  
24 impact of interest rates weren't as significant. I  
25 think that the forecast itself is -- is improved by

1 the underlying financial model that we have that is  
2 more robust and able to -- able to handle different  
3 assumptions. So the -- the volatility of the  
4 forecast, yes, that would be helped if there wasn't in  
5 -- there wasn't the interest rate volatility that we  
6 are currently forecasting.

7

8

(BRIEF PAUSE)

9

10 MS. CANDACE GRAMMOND: So what steps  
11 could be taken to make the forecasting of net income  
12 in Basic less interest-rate sensitive?

13 MS. HEATHER REICHERT: I think we have  
14 talked about that here already at the hearings. If we  
15 were more closely duration matched between our bonds  
16 and our liabilities, that would reduce the impact of  
17 any interest rate movement on the forecast for the --  
18 for the Basic Program.

19 But as we have also said, if we were to  
20 move immediately to being duration matched, that would  
21 then not allow the Corporation to benefit from  
22 increasing interest environment with our current  
23 duration mismatch being of benefit to us.

24 MS. CANDACE GRAMMOND: So in the  
25 future, would it be worth looking at decreasing the

1 mismatch even if the ultimate goal isn't to immunize a  
2 hundred percent?

3 MS. HEATHER REICHERT: I do believe it  
4 is something that is worthwhile to look at. And it is  
5 something that we are looking at and can come to the  
6 Board later this week or early next week and provide  
7 them with some information of what that would look  
8 like if we were to do it in the very near term.

9

10 (BRIEF PAUSE)

11

12 MS. CANDACE GRAMMOND: Thank you.  
13 Madam Chair, I have a fairly short section that I  
14 think I can complete within about ten (10) minutes.  
15 So with the Board's permission, I'd proceed with that.  
16 Thank you.

17 So for the purposes -- and this is to  
18 do with the break-even objective that we've been  
19 talking about and how the Corporation assesses that.  
20 Can you tell us how the Corporation measures its  
21 success in terms of meeting the break-even objective?

22 MS. MARILYN MCLAREN: I -- I think for  
23 sort of assessing -- well, I guess both in terms of --  
24 through this process with the PUB through time, both  
25 are you in the ballpark in terms of forecast compared

1 to actual and what would constitute breakeven, I -- I  
2 think we have generally talked about a range of about  
3 \$20 million, plus or minus 10 million.

4

5 (BRIEF PAUSE)

6

7 MS. CANDACE GRAMMOND: So just to  
8 clarify then, what the Corporation is looking at prior  
9 to filing the rate application, or deciding what is  
10 going to be applied for, it looks at various  
11 scenarios. And in assessing the two (2) year period,  
12 is it looking at the average net income or loss, or  
13 the total net income or loss over the two (2) years?

14 MS. HEATHER REICHERT: I -- I can  
15 clarify. I -- I believe that Ms. McLaren was  
16 responding to your question on an annual finan -- like  
17 actual financial results. How we look at that  
18 relative to what we budgeted, and do we consider being  
19 within 10 million on a actual basis from our budget,  
20 plus or minus, as -- as being pretty close to making -  
21 - making budget. And we do.

22 For the purposes, however, of rate  
23 setting we do the pro formas. We do -- without  
24 assuming any type of rate increase. We do the -- the  
25 forecasted pro formas and we look at the two (2)

1 rating years. We take the average of the net incomes  
2 on -- in those two (2) rating years. If they are a  
3 negative and a positive then they're netted.

4                   So we take that average, add them  
5 together, divide by two (2), and based on that if, for  
6 instance, sim -- simplistically, that average was 4  
7 million negative in the forecasted pro formas, and 8  
8 million represents 1 percent rate increase, then we  
9 would apply for a .5 percent rate increase that would,  
10 essentially, over the two (2) rating years generate  
11 sufficient income to offset that negative forecast of  
12 on average 4 million. So for rating purposes we try  
13 to get as close to net zero between the two (2) rating  
14 years as possible.

15                   MS. CANDACE GRAMMOND: Thank you.  
16 Let's just talk a little bit for a moment about the  
17 rationale of using the two (2) years as to -- as  
18 opposed to some other period of time. Is that a  
19 reflection of the fact that it takes in essence two  
20 (2) full years for the impact of a rate change to be  
21 fully realized because of staggered renewals?

22                   MS. HEATHER REICHERT: Yes.

23                   MS. CANDACE GRAMMOND: So would you  
24 agree that the results for the year following the test  
25 year in the current GRA, so in our case 2015/'16, will



1 also be influenced by the proposal and ultimate Board  
2 decision arising from the next GRA.

3 MS. HEATHER REICHERT: Yes, that's  
4 correct.

5 MS. CANDACE GRAMMOND: This would seem  
6 to suggest that while both the test year and the year  
7 following are important to assessing fit with the  
8 Basic break-even objective, greater weight should  
9 somehow be accorded to the net income in the test year  
10 since this GRA is basically the last chance to impose  
11 action that influences the outcome for the test year,  
12 whereas for the subsequent year we're going to be  
13 having another discussion a year from now.

14 What are your thoughts on that?

15 MS. HEATHER REICHERT: I don't -- I --  
16 I don't agree. The reason I -- I don't agree is both  
17 years are -- are critically important. We come  
18 forward asking for the rate increase for the year  
19 starting March 1st of 2014. That 1.8 percent  
20 increase, we're only effectively going to achieve .9  
21 percent in the test -- the test year, as you refer to  
22 it, and then the -- the additional .9 percent in the -  
23 - the following year.

24 So both years are equally important  
25 because the revenue that we are wanting to generate

1 from this rate proposal will equally impact both the  
2 test year and the '15/'16 year. So we -- and that's  
3 why we average them, because we consider them to be  
4 equally important to establishing the appropriate rate  
5 for the coming year.

6 MS. CANDACE GRAMMOND: Thank you. I  
7 just want to put an example forward on the same issue  
8 to -- to explore a little bit further.

9 So let's say that the Corporation is  
10 choosing between two (2) forecast scenarios identical  
11 in every respect except for the proposed rate.

12

13 (BRIEF PAUSE)

14

15 MS. CANDACE GRAMMOND: So just to  
16 clarify then, what the Corporation is looking at prior  
17 to filing the rate application, or deciding what is  
18 going to be applied for, it looks at various  
19 scenarios. And in assessing the two (2) year period,  
20 is it looking at the average net income or loss, or  
21 the total net income or loss over the two (2) years?

22 MS. HEATHER REICHERT: I -- I can  
23 clarify. I -- I believe that Ms. McLaren was  
24 responding to your question on an annual finan -- like  
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4 - making budget. And we do.

5                   For the purposes, however, of rate  
6 setting we do the pro formas. We do -- without  
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13 together, divide by two (2), and based on that if, for  
14 instance, sim -- simplistically, that average was 4  
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16 million represents 1 percent rate increase, then we  
17 would apply for a .5 percent rate increase that would,  
18 essentially, over the two (2) rating years generate  
19 sufficient income to offset that negative forecast of  
20 on average 4 million. So for rating purposes we try  
21 to get as close to net zero between the two (2) rating  
22 years as possible.

23                   MS. CANDACE GRAMMOND: Thank you.  
24 Let's just talk a little bit for a moment about the  
25 rationale of using the two (2) years as to -- as

1 opposed to some other period of time. Is that a  
2 reflection of the fact that it takes in essence two  
3 (2) full years for the impact of a rate change to be  
4 fully realized because of staggered renewals?

5 MS. HEATHER REICHERT: Yes.

6 MS. CANDACE GRAMMOND: So would you  
7 agree that the results for the year following the test  
8 year in the current GRA, so in our case 2015/'16, will  
9 also be influenced by the proposal and ultimate Board  
10 decision arising from the next GRA.

11 MS. HEATHER REICHERT: Yes, that's  
12 correct.

13 MS. CANDACE GRAMMOND: This would seem  
14 to suggest that while both the test year and the year  
15 following are important to assessing fit with the  
16 Basic break-even objective, greater weight should  
17 somehow be accorded to the net income in the test year  
18 since this GRA is basically the last chance to impose  
19 action that influences the outcome for the test year,  
20 whereas for the subsequent year we're going to be  
21 having another discussion a year from now.

22 What are your thoughts on that?

23 MS. HEATHER REICHERT: I don't -- I --  
24 I don't agree. The reason I -- I don't agree is both  
25 years are -- are critically important. We come

1 forward asking for the rate increase for the year  
2 starting March 1st of 2014. That 1.8 percent  
3 increase, we're only effectively going to achieve .9  
4 percent in the test -- the test year, as you refer to  
5 it, and then the -- the additional .9 percent in the -  
6 - the following year.

7                   So both years are equally important  
8 because the revenue that we are wanting to generate  
9 from this rate proposal will equally impact both the  
10 test year and the '15/'16 year. So we -- and that's  
11 why we average them, because we consider them to be  
12 equally important to establishing the appropriate rate  
13 for the coming year.

14                   MS. CANDACE GRAMMOND: Thank you. I  
15 just want to put an example forward on the same issue  
16 to -- to explore a little bit further.

17                   So let's say that the Corporation is  
18 choosing between two (2) forecast scenarios identical  
19 in every respect except for the proposed rate level  
20 change for the purposes of putting one (1) forward at  
21 the GRA.

22                   The first scenario forecasts net income  
23 of a loss of 1 million in the test year and an income  
24 of 1 million in the year following. So for a -- a two  
25 (2) year total net income of zero.

1                   The second scenario forecasts net  
2 income of zero in the test year and 2 million in the  
3 year following for a two (2) year total of 2 million  
4 in net income, or an average of 1 million if you  
5 looked at the two (2) years together.

6                   So what would the Corporation's thought  
7 process be for deciding between those two (2)  
8 scenarios?

9

10   (BRIEF PAUSE)

11

12                   MS. MARILYN MCLAREN:    It might be,  
13 Wow, did those two (2) scenarios ever come close  
14 together.    I -- I would like us to avoid going down a  
15 rabbit hole on this.    You know, I mean I -- so maybe  
16 we can figure out a little more specifically what it  
17 is -- where you're heading and what you're suggesting.

18

19                   I mean, the reality is this is the last  
20 chance to have an impact on '14/'15, but only half of  
21 what happens in '14/'15 will be affected by the dec --  
22 this decision on rates.    Basically, you know, half the  
23 decision on what happens in '14/'15 will be driven by  
24 what's happening this year in '13/'14.    You know, and  
25 we need to talk about the fact that we are here not

1 changing our forecast for the year -- rarely changing  
2 the forecast for the year.

3           So, I mean, if we have -- if we're  
4 looking at something that tells us we're going to  
5 break even in the test year and then make money, I'm  
6 more comfortable in sort of just talking in those  
7 terms without sort of the zeros, and the ones, and the  
8 twos, because they're such small numbers, right. So,  
9 I mean if you're looking at breaking even and then  
10 making a lot of money in the '15/'16 year, materially,  
11 significantly more profitable, I -- I cannot recall  
12 that that has happened and influenced our application.

13

14           But if it was to happen, some of the  
15 things that we would think about is how likely is that  
16 '15/'16 to actually transpire? If we're really going  
17 to break even with a forecast that is very -- on the  
18 same basis in both of the test years -- and we really  
19 do tend to think of them as both of the test years  
20 inside MPI, If we understood why and we believed that  
21 that was something that was going to continue, we may  
22 very well apply for a rate decrease in the '14/'15  
23 year even if it was going to break even and we were  
24 looking at a large increase in the subsequent year.

25

          But if it was somewhat uncertain, if it

1 was based on something like our -- our best estimate  
2 of interest rates, or potentially the -- the cost of  
3 something -- some sort of new coverage or something  
4 like that, then -- then we may behave differently.

5 But having really different results in  
6 an unexplainable kind of way in the two (2) years is -  
7 - it's not something that's happened to a significant  
8 extent. You know, I mean, you could -- rather than  
9 your zero, and your 1, and your 2, you could talk  
10 about, you know, this year we're going to -- this year  
11 we lose a bit, next year we make a bit, or -- or the -  
12 - meaning '14/'15, '15/'16, so that -- that does not  
13 drive a decision one (1) way or the other based on  
14 which is negative and which is positive.

15 They're both in the ballpark. We  
16 understand what they are and we do really think of it,  
17 to the extent that's reasonable, in our view as two  
18 test years.

19 MS. CANDACE GRAMMOND: Thank you,  
20 Madam Chair. That completes that section. So just  
21 for everyone's knowledge, I do have a little bit left,  
22 probably somewhere between half-an-hour and an hour,  
23 I'm guessing, that I'll pursue tomorrow morning. And  
24 then I'll turn the mic over to My Friend Mr. Williams.

25 THE CHAIRPERSON: Ms. Kalinowsky...?



1 MS. KATHY KALINOWSKY: Thank you very  
2 much. I know Ms. Reichert has a transcript in her  
3 hand and she just wanted to read something in that was  
4 mentioned in direct-examination, and it was in  
5 response to a question that I posed to her in the  
6 first day. And it was a question that pose --  
7 garnered a lot of interest from the Board members and  
8 it was with respect to the interest rate forecast and  
9 what were the options for the Public Utilities Board.  
10 So we've just gone through a whole bunch of different  
11 scenarios of, you know, different types of interest  
12 rate forecasts. So I'll ask Ms. Reichert to read in  
13 her response there. Thank you.

14 MS. HEATHER REICHERT: Thank you. So  
15 the options for -- for the Board:

16 "Essentially, the Public Utility  
17 Board will need to decide to what  
18 extent, if at all, they will  
19 substitute the Corporation's  
20 judgment for their own. If interest  
21 rates continue to be more favourable  
22 than our forecast, and the PUB  
23 approves the rate increase, then the  
24 RSR will be returned to the DCAT-  
25 driven target more quickly.

1 If interest rates continue to be  
2 higher than our forecast, and the  
3 Public Utility Board disallows any  
4 rate increase, then it will take  
5 longer to rebuild the RSR. And if  
6 interest rates prove to follow the  
7 recent history of increases and  
8 decreases, and the Public Utility  
9 Board disallows any rate increase, I  
10 do expect that next year we will be  
11 here asking for both a rate increase  
12 and an RSR building surcharge."

13 MS. KATHY KALINOWSKY: So thank you.  
14 And can you give the transcript page number for that?

15 MS. HEATHER REICHERT: I'm sorry.  
16 Yes, I can. It is transcript from 9/24/2013, page 69.

17 MS. KATHY KALINOWSKY: Thank you.

18 THE CHAIRPERSON: Okay. Thank you  
19 very much. That concludes our hearing for today. And  
20 we will reconvene tomorrow at 9:30. Thank you.

21

22 --- Upon adjourning at 4:02 p.m.

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3 Certified correct,

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8 Cheryl Lavigne, Ms.

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