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

APPEARANCES

Candace Grammond	)Board Counsel
Kathy Kalinowsky	)MPI
Byron Williams	)CAC (Manitoba) Inc.
Raymond Oakes	)CMMG
Liz Peters (np)	)CAA

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

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

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

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

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

MS. MARILYN MCLAREN: Exactly

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

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

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

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

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

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

MS. CANDACE GRAMMOND: Thank you.

MPI PANEL:

MARILYN MCLAREN, Resumed

HEATHER REICHERT, Resumed

LUKE JOHNSTON, Resumed

CONTINUED CROSS-EXAMINATION BY MS. CANDACE GRAMMOND:

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

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

MR. LUKE JOHNSTON: I'm there.

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

(BRIEF PAUSE)

THE CHAIRPERSON: Thank you, we're good.

CONTINUED BY MS. CANDACE GRAMMOND:

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

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

"The best-estimate present value of cashflows relating to the revenue at the indicated rate should equal the best-estimate present value of cashflows relating to the corresponding claims costs and expense costs plus the present value of a provision for profit over a specified period of time."

Is that right?

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

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

"Without bias, neither conservative nor unconservative."

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

MR. LUKE JOHNSTON: Yes, it is.

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

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

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

Is that correct?

MR. LUKE JOHNSTON: Yes.

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

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

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

What I alluded to in -- in this response was that there was a time where we did attempt to do a procedure, basically as described in -- in here. But in the end we always had to balance back to breakeven rates. And one (1) of the -- one (1) of the big pieces of that is the investment income.

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

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

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

MR. LUKE JOHNSTON: That's right. And that's maybe a better -- a quicker summary of what I -- what I just stated. The -- that is the -- the goal that we are always trying to achieve with our rate applications, to -- to break even in that fiscal period.

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

MS. CANDACE GRAMMOND: Absolutely.

CONTINUED BY MS. CANDACE GRAMMOND:

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

MR. LUKE JOHNSTON: And I confirm that.

(BRIEF PAUSE)

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

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

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

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

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

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

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

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

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Thank you. Now, Mr. Johnston, the response here at PUB/MPI-1-41A takes us back to the 1992 rate application to learn the rationale for the rate-making approach followed in the GRA.

Can you comment on that and outline that rationale?

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

"Using this method, the resulting required premium is higher because only investment income earned from the current year's policies is accounted for. For example, investment income from retained earnings is not used as a premium offset. Due to the Corporation's nonprofit mandate, this income should be used as a prima offset and, therefore, the method described under section 2.3.1, i.e. the Corporation's current rate-making methodology, is more consistent with the goals of the Corporation."

End quote. So that -- that's

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

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

(BRIEF PAUSE)

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

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

But I do remember the first time Mr. Pelly was supporting the Board in these proceedings. And I remember one (1) of those off-microphone conversations between our chief actuary at the time, Don Palmer, Mr. Pelly, and myself talking about exactly this issue and Mr. Pelly struggling with the concept of why all that investment income was in our rate-making methodology as an offset to revenue.

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

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

So that's basically how we've done it since well before that year, when Mr. Pelly joined us. And it is really from -- it's the best presentation that we have, and the simplest presentation, of that principle of public auto insurance and how we actually do calculate our revenue requirement.

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

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

(BRIEF PAUSE)

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

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

MS. MARILYN MCLAREN: Well --

MR. REGIS GOSSELIN: I think stability's a goal. That's all our goal is right there, to share some rate stability. But I guess I'm wondering, if we were to choose an alternative method, what does it mean for the rates in terms of variability?

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

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

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

If there's value in that, I guess we could think about doing that, but as long as we understand what we're doing and why and how in every other way this is highly consistent and -- and within and follows tightly actuarial guidelines. I -- I don't think -- I don't think we want to start talking about actually impacting Manitobans differently.

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

CONTINUED BY MS. CANDACE GRAMMOND:

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

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

off-balance adjustment.

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

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

(BRIEF PAUSE)

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

MR. LUKE JOHNSTON: The -- if -- if you're changing how you look at all the expected costs and expenses with a particular group of policies, it's possible that it -- it could change the underlying indicated rate for different groups. You'd also have to consider how that ending investment income, adjustment applies to the different classes.

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

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

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

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

MS. CANDACE GRAMMOND: Thank you.

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

accepted actuarial
practice in Canada would
be higher than, the same
as, or lower than that
which is now applied for,
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economic, and investment
climates

CONTINUED BY MS. CANDACE GRAMMOND:

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

Would you agree?

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

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

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

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

(BRIEF PAUSE)

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

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

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

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

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

(BRIEF PAUSE)

CONTINUED BY MS. CANDACE GRAMMOND:

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

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

MR. LUKE JOHNSTON: Yeah, it's a dif -- it's just a little bit difficult to say exactly which this would fall in, but I -- I think in general the -- if -- similar to the -- the DCAT, for example, if -- if our regulatory environment is asking for a certain -- things to be honoured a certain way, we set rates, you know, this way based on an agreed PUB-approved methodology that we've used for many years.

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

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

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

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

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

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

(BRIEF PAUSE)

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

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

Would -- would you agree with that?

MR. LUKE JOHNSTON: Yes.

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

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

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

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

CONTINUED BY MS. CANDACE GRAMMOND:

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

(BRIEF PAUSE)

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

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

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

CONTINUED BY MS. CANDACE GRAMMOND:

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

MR. LUKE JOHNSTON: Thank you.

MS. CANDACE GRAMMOND: So just a

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

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

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

MS. CANDACE GRAMMOND: Yes.

(BRIEF PAUSE)

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

We may not pro -- again, as -- as we've discussed, we may not propose that rates move in that direction. But in that case, I could provide an opinion stating that these -- these are the rates that are calculated per actuarial standards and -- and, as we discussed again, here -- here are the reasons for -- that I've deviated from those standards.

MS. CANDACE GRAMMOND: Thank you. Okay.

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

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Thank you. So I'm going to move then into a different actuarial area which relates to forecasting accuracy and the contex -- context of claims incurred. So I will ask you to turn to PUB/MPI-1-36, which is not in the Board's book. So 1-36.

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

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

during that fiscal period.

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

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

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

Is that right?

MR. LUKE JOHNSTON: That's correct.

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

MR. LUKE JOHNSTON: Yes.

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

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

MR. LUKE JOHNSTON: Correct.

MS. CANDACE GRAMMOND: Okay, so

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

(BRIEF PAUSE)

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

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

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

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

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

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

Moving to collision, again these are basically just -- there's not multiple covers on collision. If you go through the collision line, I think I would characterize that as fairly good performance on -- on predicting cover counts. Winters are going -- you know, good or bad winters are going to basically be why -- the main reason why we deviate from that. Also, bigger than expected changes in fleet size are -- is another common reason.

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

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

And for liability, we're talking really

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

(BRIEF PAUSE)

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

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

MR. LUKE JOHNSTON: I -- I will find the Information Request on that, but that is almost completely from the new claims management system. And a -- a good -- a quick example would be a claim comes in. It auto reserv -- if -- if the expectation is this type of claim needs chiro -- chiropractic or physiotherapy, it auto reserves expectations to those amounts, where in the old world the case manager would, you know, sit down, look at it, decide which one they're going to put the money in, or...

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

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

CONTINUED BY MS. CANDACE GRAMMOND:

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

(BRIEF PAUSE)

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

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

Would you agree?

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

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

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

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

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

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

Is that right?

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

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

MR. LUKE JOHNSTON: Correct.

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

(BRIEF PAUSE)

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

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

So in -- in general, now that we've made these changes, we've -- my expectation is you're going to see, you know, sometimes above, sometimes below. It happens that the last couple of years have been -- been above, but that -- that's going to happen with PIPP. You're going to get -- you're going to get variability in the numbers.

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

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

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

Comprehensive coverage, again, should echo the -- the cover -- or the -- the frequency comparison. We're showing slightly more favourable than that which, again, was better than expected results on theft-related perils.

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

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

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

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

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

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

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

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

(BRIEF PAUSE)

MR. LUKE JOHNSTON: I would like to check to -- with my back row and maybe at the break to make sure that the benefit enhancements were in the original and projected forecast just to make sure that if -- if they were in there, in -- you know, because when they came out in 2010, I believe, it -- it might not have been known at the time of the original forecast that those were coming. So I'll check that.

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

(BRIEF PAUSE)

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

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

MS. CANDACE GRAMMOND: Thank you.

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

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

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

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

Is that right?

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

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

Is that right?

MS. HEATHER REICHERT: Yes.

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

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

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

MS. HEATHER REICHERT: Yes, that is correct.

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

MS. HEATHER REICHERT: Correct.

MS. CANDACE GRAMMOND: Now, we understand that the new financial model was developed by a consultant under the supervision of the corporate controller, the chief actuary Mr. Johnston, the acting investment manager, and their respective teams.

Is that right?

MS. HEATHER REICHERT: Yes, that is correct.

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

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

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

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

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

Can you comment on that?

MS. HEATHER REICHERT: Yes, I can. I -- and I think the -- the best response might be to read in how we responded in one of the -- the Information Requests:

"The Corporation uses various models to support our overall rate indication. They are large and complex, the ones the actuaries use as well as the ones that we use for financial modelling. The Corporation expects that an independent -- independent analyst that is untrained with the Corporation's model would need to invest a significant amount of time and effort to be capable of operating the model correctly. Allowing other parties to work in and modify spreadsheets and pose questions and Information Requests and on cross-examination based on the modified schedules will also require the Corporation to invest a significant amount of time analyzing the changes made to the spreadsheets and to understanding their potential impacts.

This approach, in our opinion, is inefficient. It would require addition time to be provided within the regulatory process, and would make the regulatory process more cumbersome. The Corporation has not provided the full versions or the underlying Excel files with formulas of these models to the Public Utilities Board and Intervenors in past general rate applications. The Corporation has provided very detailed support for all the models, including the investment income model, as part of the GRA, part of the interrogatory, and rehearing processes."

And I did hand out -- or we handed out as an exhibit at -- on the first day, I believe, a summary of just a snapshot of all of the various scenarios that were run by the Corporation in response to requests made by both the Public Utility Board and the Consumers' Association where we assumed different assumptions with respect to interest rates, or volumes, or upgrades, or -- or whatever was -- was requested.

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

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

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

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

MS. HEATHER REICHERT: It is just a matter of -- of timing. We -- we are continuing to work with our consultant on the financial model, as I indicated, to incorporate the balance sheet. And when we have that aspect incorporated, we will receive full documentation of the testing that has been done on the entire model. So really, it was just the matter of timing, getting all of that documentation in place in time for this -- for this hearing.

(BRIEF PAUSE)

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

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

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

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Thank you. Now, I understand that -- back to the issue of investment rebalancing -- the new forecasting model assumes a rebalancing between the current investment targets for each investment class?

MS. HEATHER REICHERT: Yes, that is correct.

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

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

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

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

(BRIEF PAUSE)

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

MS. CANDACE GRAMMOND: Thank you.

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

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

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Thank you, Ms. Reichert. So let me ask you this: To the extent that at a given per -- or point in time, the amount held within a particular investment class may be different than the range that's provided in the re-balancing policy -- and that does happen from time to time for different reasons -- would there not be, then, the potential for a departure from what the model reflects, or what the model -- what the model would reflect?

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

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

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

MS. HEATHER REICHERT: So the financial model that we have -- have built, with its underlying assumptions, is doing a best estimate given the -- the assumptions that are un -- underlying it. So to the extent that we are modelling for re-balancing to occur based on -- on criteria built within the model, to the extent that that doesn't happen in real life, there will be differences from -- between your forecast and what actually occurs.

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

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

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

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

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

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

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

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

consecutive quarters, the asset
class will be adjusted to the target
weight in the following quarter.
[So] The total portfolio
reallocation requirements will be
sourced from or reallocated in the
following proportions: to Canadian
equities, 75 percent, and US
equities, 25 percent."

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

If within the model it increases beyond the -- the targeted ranges that we have, the model will then re-balance. It will get it back to the range that it needs to be within, and it will do that by saying, Okay, if we have to remove 10 million of marketable bonds from a particular quarter, it will re-balance it by saying, Okay, 10 million, we're going to purchase 75 percent of that 10 million, so whatever, seven million five hundred thousand (7,500,000) worth of Canadian equities and two million five hundred thousand (2,500,000) worth of US equities.

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

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

Where the -- where does the 2 percent go?

(BRIEF PAUSE)

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

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

MS. CANDACE GRAMMOND: Thank you. Madam chair, I just have a couple more questions on this. But I'm happy to take the morning break and deal with those when we come back.

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

--- Upon recessing at 10:46 a.m.
--- Upon resuming at 11:03 a.m.

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

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

THE CHAIRPERSON: Okay. Thank you very much.

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

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Okay. So I'm actually going to leave the area regarding rebalancing. I'm going to go into a different area dealing with forecasting, and that is with respect to the linear, exponential, and financial forecasts that we have dealt with at the Board in the past.

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

Can you comment on the reasons for that?

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

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

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

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

(BRIEF PAUSE)

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

"The financial forecast involves a more thorough analysis of each forecast variable than the linear and exponential methods."

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

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

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

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

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

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

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

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

MR. LUKE JOHNSTON: Confirmed.

MS. CANDACE GRAMMOND: Now, it seems as though the divergence between the financial forecast on the one hand and the linear and exponential forecast on the other has grown this year.

Would you agree?

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

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

(BRIEF PAUSE)

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

The other one would probably be

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

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

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

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

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

MR. LUKE JOHNSTON: Correct.

MS. CANDACE GRAMMOND: Which makes it

revenue neutral?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Sorry, yes.

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

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

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

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

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

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

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

(BRIEF PAUSE)

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

So we see -- and -- and for the purposes of the record we can mark this as an exhibit, but we don't necessarily need to, because it is just excerpts of the existing filing. I don't know if Ms. Kalinowsky has a preference?

MS. KATHY KALINOWSKY: Sure.

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

(BRIEF PAUSE)

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

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

CONTINUED BY MS. CANDACE GRAMMOND:

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

But, Mr. Johnston, first of all perhaps you could, just to refresh all of our memories, remind us about what stochastic modelling is and how it has been applied in the GRA before the Board?

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

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

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

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

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

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

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

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

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

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

And we've got a range of years, from

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

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

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

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

So when you turn to page 88, what the table on the -- on the top is saying is, How much can we deviate on a cumulative basis from our base forecast as each -- as time passes -- as each year passes.

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

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

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

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

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

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

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

MR. LUKE JOHNSTON: Correct.

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

(BRIEF PAUSE)

MR. LUKE JOHNSTON: I'm thinking there's an IR on this but I can -- I can speak to it from memory. We're always -- like any component of the DCAT or stochastic model, we -- we're always looking for -- for ways to improve that model.

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

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

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

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

THE CHAIRPERSON: Yes.

MS. CANDACE GRAMMOND: Thank you.

THE CHAIRPERSON: Yes.

(BRIEF PAUSE)

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

CONTINUED BY MS. CANDACE GRAMMOND:

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Confirmed.

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

(BRIEF PAUSE)

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

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

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

MS. CANDACE GRAMMOND: Now, if we can discuss -- if we can discuss in a little bit more detail the unfavourable runoff for 2012/'13, perhaps you can comment on -- or give us an overview of the sources of that unfavourable runoff?

(BRIEF PAUSE)

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

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

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

MS. CANDACE GRAMMOND: Thank you. And can you tell us whether there is any aspect of that unfavourable runoff that the Corporation considers particularly worrisome or alarming?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: I wouldn't cla -- cla -- clarify it as alarming. Obviously we're not pleased that our results are, particularly for weekly indemnity, higher -- higher than expected. We are keep -- as -- as we'll talk about from the first quarter results and -- and last year's results, we are keeping our eye very closely on the payment and reserving patterns under the new claims management system.

And I don't know if I need to call that alarming in any way, but different. And it's -- so what -- from the actuarial side, we're -- we're definitely trying to understand how that system has changed some of our -- our payment patterns, what we need to do to properly estimate those amounts in the October and February reviews.

MS. CANDACE GRAMMOND: Thank you. Now, at the outset of this area I had asked you to go to Tab 22 of the Board's book of documents and to keep that open. So we'll go there now.

I'd ask you to confirm with respect to

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

(BRIEF PAUSE)

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

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

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

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

Particularly it looked like paid losses were being paid either faster or -- or by a greater amount while reserves were quite a bit lower than -- than normal. So what we talk about when I talked earlier about this higher-of method that we use where we look at both paid and reported losses in the early years of a claim, we had a growing discrepancy there with paid looking like it was higher but case reserves looking like they were lower.

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

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

> "The bulk of the unfavourable runoff, 39.3 million, stems from unfavourable runoff of 37.8 million for accident benefits weekly

indemnity, and..."

I'll skip the next sentence, and then it says:

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

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

So you're looking at basically a full -- full, possibly even more than a full, year's worth of reserves being added in March, which obviously makes us look significantly over budget relative to one (1) -- to one (1) month. What we've seen for the remainder of the year so far is very -- very little if -- and in some cases negative reserves added or -- or adjusted.

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

MR. LUKE JOHNSTON: In -- per my previous comments, in a general sense there's -- we didn't modify any of the -- the assumptions used in the previous actuarial report. For example, we didn't select new loss development factors. Because doing so -- we have our external actuar -- actuarial review. Our external actuary has agreed to those assumptions and it's our view that it would be premature to start changing those assumptions prior to -- to the review with that -- with our -- with our external actuary.

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

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

(BRIEF PAUSE)

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

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

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

(BRIEF PAUSE)

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

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

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

(BRIEF PAUSE)

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

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

Can you comment on what that IBNR provision is?

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

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

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

MR. LUKE JOHNSTON: Yes.

MS. CANDACE GRAMMOND: Thank you.

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

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

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

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

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

Can you comment on what that is?

MR. LUKE JOHNSTON: Yeah, these are

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

(BRIEF PAUSE)

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

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

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

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

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

MR. LUKE JOHNSTON: Correct.

MS. CANDACE GRAMMOND: Now, the second

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

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

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

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

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

(BRIEF PAUSE)

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

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

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

MR. LUKE JOHNSTON: Correct.

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

Is that fair to say?

MR. LUKE JOHNSTON: That's fair, yes. And in recent years, the effect of discounting has gotten smaller and smaller as our interest rates have -- have declined and where -- again, where the liabilities are matched to the fixed income portfolio. But those are -- as you've described, I can confirm.

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

Is that right?

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

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

MR. LUKE JOHNSTON: Correct.

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

MR. LUKE JOHNSTON: Correct. Correct.

MS. CANDACE GRAMMOND: Thank you. Now, looking at line 5 adjusted IBNR PIPP enhancement, can you comment on what gives rise to that particular adjustment for an addition of 51 million?

(BRIEF PAUSE)

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

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

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

MR. LUKE JOHNSTON: Correct.

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

Can you explain what gives rise --

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

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

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

(BRIEF PAUSE)

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

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

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

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

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

MR. LUKE JOHNSTON: Correct.

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

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

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

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

MR. LUKE JOHNSTON: Correct. And I'm

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

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

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

MS. CANDACE GRAMMOND: Thank you.

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

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

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

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

MS. KATHY KALINOWSKY: Not just one

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

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

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

MS. KATHY KALINOWSKY: Undertaking number...

(BRIEF PAUSE)

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

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

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

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

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

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

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

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

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

--- EXHIBIT NO. MPI-16: Response to Undertaking number 13

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

MS. KATHY KALINOWSKY: Thank you very much.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Thank you.

CONTINUED BY MS. CANDACE GRAMMOND:

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

(BRIEF PAUSE)

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

So if we go over to the first attachment, which is the second page at Tab 25. My intention, just so you know what I'm about to do, is to go through each of these and ask for some commentary on each one. So we'll start with the first one, which is the -- we -- we asked for a change to the July 2013 interest update.

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

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

(BRIEF PAUSE)

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

MS. HEATHER REICHERT: Okay. So in

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

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

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

When you look across to the rating years, which are 2014 and 2015, you can see there underlying our total investment income what we are forecasting as the unrealized and realized losses with respect to marketable bonds in the rating years. So just for clarity, in '14/'15, marketable bonds unrealized losses, we forecasted twenty-nine million, four hundred and fifty-two (29,452,000). In '15/'16 we forecasted twenty-eight million, two hundred and twenty-six (28,226,000); and in realized gains for 2014 nine hundred and forty (940); and in 2015, for realized losses eleven million, one hundred and ten (11,110,000). And these are all in thousands of -- of dollars.

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

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

(BRIEF PAUSE)

MS. HEATHER REICHERT: So while Mr.

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

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

And that positive number, plus the assumption within the base, is that we have a 1.8 percent rate increase. So with a 1.8 percent rate increase with the forecasted increasing interest rates, as we've talked about here before, that presented us with a net income of 5,472,000 in 2014, a negative 7,494,000 in 2015. and as we talked about previously, we look at the two (2) years, the average, which is on average a loss of 2.5 million, which is considered close enough to break even for rate setting purposes.

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

(BRIEF PAUSE)

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

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

interest rates as of April of 2013.

Is that right?

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

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

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

MS. HEATHER REICHERT: Correct. So we -- now, to be very clear, we used the methodology requested by the Board which was using the bank forecasts in July of 2013 and forecasting as MPI had forecasted in previous GRA applications. So not taking the bank interest rates over five (5) years, and assuming that they would occur over ten (10). Taking the bank interest rates forecasted over the five (5) years, as we had in the past, taking the average of those and applying it to the rating years.

MS. CANDACE GRAMMOND: Thank you. And, so we see for the 2014/'15 fiscal year, which is listed here as 2014-P, we see that the Basic net income increased under that set of assumptions to about over 37 million from the five point four (5.4) as applied?

MS. HEATHER REICHERT: That is correct.

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

MS. HEATHER REICHERT: Correct.

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

MS. HEATHER REICHERT: Yes.

MR. REGIS GOSSELIN: Could we quantify that interest rate increase that we used for the projection that you're referring to?

(BRIEF PAUSE)

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

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

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

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

The July standard rate forecast that

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

Does that help? Is that helpful?

(BRIEF PAUSE)

CONTINUED BY MS. CANDACE GRAMMOND:

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

Is that right?

MS. HEATHER REICHERT: Which, of course, that tempering is what impacted on the different interest rate forecasts. So the difference between the base and the standard at 'A' is a difference in the interest rate forecast. We arrived at them -- yes, we did arrive at them two (2) different ways, but fundamentally the only difference between those two (2) is the assumed interest rate between our forecast and 'A' -- Line A.

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

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

MS. HEATHER REICHERT: So if the Corporation believed the forecast at Line A, which we've discussed why -- why we've got concern with assuming that high of an interest rate increase over the rating years, but if we believe those interest rate forecasts to be appropriate, what this would tell us is that the average on those rating years is 45 million divided by two (2), so 22 1/2 million, at 8 million equalling 1 percent. That would indicate approximately two point seven (2.7) -- I don't know, something like that, two point seven (2.7) rate reduction, but that's after -- this is already assuming a 1.8 percent increase.

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

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

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

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

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

(BRIEF PAUSE)

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

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

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

(BRIEF PAUSE)

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Thank you. Now, Ms. Reichert, when we compare that revised -- or those revised forecasts, as requested by the Board at 'B' to what MPI has applied for, we don't see a huge variance. We -- if we look at the shaded section under 'B' we see what the changes are both to net income and retained earnings. And the numbers are, by our standards, fairly small.

Is that fair to say?

MS. HEATHER REICHERT: Yes, it is.

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

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

Is that right?

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

(BRIEF PAUSE)

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

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

MS. CANDACE GRAMMOND: Yes.

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

(BRIEF PAUSE)

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

MS. HEATHER REICHERT: No.

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Now --

(BRIEF PAUSE)

MS. HEATHER REICHERT: Sorry.

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

MS. HEATHER REICHERT: Yes.

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

(BRIEF PAUSE)

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

And I -- I do recall that the Board

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

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

MS. HEATHER REICHERT: So we chose to use this minimum rolling average, again as I said, to improve the estimates from prior years. When we use the premium equity risk -- or equity risk pre -- premium, and we see such a low estimate, we did not believe that was a best reasonable estimate for equities.

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

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

Would you agree?

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

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

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

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

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

(BRIEF PAUSE)

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

The impact of line item C to the base

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

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

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

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

MS. HEATHER REICHERT: Correct.

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

MS. HEATHER REICHERT: That's correct.

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

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

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

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

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

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

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

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

MS. HEATHER REICHERT: That is correct.

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

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

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

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

MS. CANDACE GRAMMOND: Thank you. And we see under the revised scenario for the current year, which is labelled, "2014-P," we have an increase in net income of about 4.8 million, and subsequent increases for the year of the application and so forth?

MS. HEATHER REICHERT: Correct.

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

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

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

Can you comment on what that relates to?

MS. HEATHER REICHERT: In -- within the forecast there was a -- an input error made that resulted in us overstating amortization for some data processing equipment by about 1.2 million. And when you look at the impact of that, had -- had it reflected the correct amortization, our forecasted expense for 2015 would have increased by the 1.2 million, and 2015/'16 negligible. So, again, on an average over the rating period basis, about six hundred thousand (600,000). So it would not have impacted what we were asking for in rates, which is why we did not amend our rate application.

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

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

MS. CANDACE GRAMMOND: Okay. So going then to the very bottom rows we see, if I understand it correctly, the numbers reflecting all of these adjustments. Because as we've gone through in this level of detail between 'A' and 'F', some of the alternate scenarios have resulted in greater funds for the Corporation, some in lesser. So this -- this very bottom scenario brings everything together as if all six (6) of these changes asked about by the Board were implemented in the Application.

Is that right?

MS. HEATHER REICHERT: Yes, that is true.

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

MS. HEATHER REICHERT: Yes.

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

Would that be fair to say?

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

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

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

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

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

MS. HEATHER REICHERT: Okay. Noted.

MS. CANDACE GRAMMOND: It's page 33 of

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

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

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

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

MR. REGIS GOSSELIN: Six point two

(6.2). And in the US was?

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

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

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

(BRIEF PAUSE)

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

"The Corporation has proposed therefore adding a minimum equity return to the existing methodology based on the 5th percentile of annual returns on the TSX over all rolling twenty (20) year periods. The 5th percentile was 6.1 percent as of February 29th, 2012, and the use of the revised forecast methodology yields a minimum forecasted annual equity return of 6.1 percent, which MPI has incorporated in this application."

(BRIEF PAUSE)

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

(BRIEF PAUSE)

MS. HEATHER REICHERT: I'm there.

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

"Last year the 5th percentile equity

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

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

MS. HEATHER REICHERT: No.

(BRIEF PAUSE)

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

(BRIEF PAUSE)

MS. HEATHER REICHERT: Both this year and last year the intent was to use the minimum twenty (20) year -- what is it, the twenty (20) year rolling return. And so that was the intent last year. That was what we understood that was accepted by the Board and that was we had calculated to use in this forecast this year.

MS. CANDACE GRAMMOND: Thank you.

(BRIEF PAUSE)

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

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

Is that right?

MS. HEATHER REICHERT: Yes.

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

Is that right?

MS. HEATHER REICHERT: Yes, it is.

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

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

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

MS. HEATHER REICHERT: Right. I -- I

agreed with that statement.

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

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

MS. HEATHER REICHERT: Okay, maybe I can approach it this way. So I appreciate with respect to marketable bonds there are two (2) main components that will impact the investment income of the Corporation. One (1) is the actual coupon rate of the bond itself, and the second is the market value of that bond. As interest rates go up or down, the market value of that bond will decrease or increase. So the coupon income from the entire portfolio, that would change if we bought and sold bonds during the year. If we bought a bond at the beginning of the year and kept it the entire year, the coupon rate for that bond would not change. T

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

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

MS. CANDACE GRAMMOND: Thank you.

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

MS. HEATHER REICHERT: I know.

CONTINUED BY MS. CANDACE GRAMMOND:

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

Is that right?

MS. HEATHER REICHERT: Absolutely.

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

Is that right?

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

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

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

CONTINUED BY MS. CANDACE GRAMMOND:

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

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

MS. CANDACE GRAMMOND: Yes.

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

(BRIEF PAUSE)

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

because of the decline in coupon income on new investments?

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

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

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

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

So we will -- the undertaking is to provide the split of the 40.6 million between what the impact of the interest rate is on the market value of the bonds and the change in coupon rate impact on investment income.

MS. CANDACE GRAMMOND: Thank you. With that answer and your clarification that the offset is actually very small, we're satisfied and so we don't need you to give us the undertaking to find the precise number. We just wanted to have a sense of the amount.

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

Would you agree?

(BRIEF PAUSE)

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

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

Now we're talking about the lower coupon rate on new investments and that that conversely actually carries forward into subsequent periods, all other things being equal?

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

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

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

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

Agreed?

MS. HEATHER REICHERT: Agreed.

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

Would that be fair to say?

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

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

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

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

(BRIEF PAUSE)

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

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

MS. HEATHER REICHERT: Yes.

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

MS. HEATHER REICHERT: Yes. Yes.

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

MR. LUKE JOHNSTON: Yes.

MS. CANDACE GRAMMOND: Is there any other --

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

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

And the answer was 'yes'.

CONTINUED BY MS. CANDACE GRAMMOND:

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

MR. LUKE JOHNSTON: Yeah, there -- there are -- there's a few ways. The yield on non-marketable bonds. That -- that's the book yield. So similar to interest rates in general then our new non-marketable bond purchases have had a lower coupon rate. And we've seen that -- that category decline over time. So the -- that's a -- that's a fairly big chunk of -- of our assets that are used -- that are matched to liabilities.

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

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

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

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

MS. CANDACE GRAMMOND: Okay.

(BRIEF PAUSE)

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

MR. LUKE JOHNSTON: Yeah, that's -- that's my view. Again, the -- the coupons are not like a consideration in -- in the discount rate, just the yield -- yield to maturity. So that would be my understanding.

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

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

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

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

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

(BRIEF PAUSE)

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

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

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

one (1) important piece.

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

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

(BRIEF PAUSE)

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

MR. LUKE JOHNSTON: Since we use the book yield in the liability discount rate calculation, and -- and that's also how those bonds are held for accounting purposes, the -- there shouldn't be a significant effect from that other than the one I already mentioned, just the long -- you know, the long-term trend in the yield to maturity of MUSH bonds has pulled down the -- the liability discount rate. But for short-term changes that shouldn't be a huge consideration -- or a significant consideration.

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

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

(BRIEF PAUSE)

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

THE CHAIRPERSON: Thank you, Ms.

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

--- Upon recessing at 2:31 p.m.
--- Upon resuming at 2:53 p.m.

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

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

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

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

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

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: So we've been

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

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

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

(BRIEF PAUSE)

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

So corporate -- corporate change in net claims incurred would be bigger than this number but not by a significant amount.

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

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

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

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

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

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

MS. HEATHER REICHERT: Totally. Absolutely.

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

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

If that were the case, the very first

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

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

(BRIEF PAUSE)

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

I understand that the duration of the

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

Would you agree?

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

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

MS. HEATHER REICHERT: We continue to forecast that the duration mismatch, if you will, between our assets and our liabilities remained at the one point eight (1.8) year span, because that is what it has been over -- on average over several years. And we did that, yes, strategically to take advantage of the fact that in the increasing interest rate environment that is being forecasted by all of the banks, and including ourselves in our -- in our base forecast, having that -- that mismatch of one point eight (1.8) years is a larger benefit to the Corporation. When interest rates were decreasing over the past five (5) years or so, we had that same mismatch. And it hurt the Corporation significantly, because the opposite was happening. It -- it was a -- a net negative impact to the Corporation.

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

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

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

MS. CANDACE GRAMMOND: And can you tell us who is charged with the responsibility for making recommendations under this strategy?

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

MS. CANDACE GRAMMOND: Yes.

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

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

You know, with -- with hindsight we probably -- we certainly did consult with Mr. Gibson with respect his comfort level with that assumption, as with the bond portfolio turnover. Those would be the key assumptions that -- that were highlighted for him. It -- it was probably not as pointed conversation that we probably will evolve to through time. It was more, Does this seem reasonable, as opposed to, Is this something you are prepared to live with. But it really come -- came out of the Corporation's forecasting process, the Corporation's operational needs, and was vetted to an extent with the bond manager.

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

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

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

With the onset of this new financial model, and with watching what had happened with the changes in interest rates and the actual net impact to the overall financial position of the Corporation, we now are much more sensitive to the fact that in the increasing interest rate environment that is being forecasted by all of the banks, and including ourselves in our -- in our base forecast, having that -- that mismatch of one point eight (1.8) years is a larger benefit to the Corporation. When interest rates were decreasing over the past five (5) years or so, we had that same mismatch. And it hurt the Corporation significantly, because the opposite was happening. It -- it was a -- a net negative impact to the Corporation.

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You know, with -- with hindsight we probably -- we certainly did consult with Mr. Gibson with respect his comfort level with that assumption, as with the bond portfolio turnover. Those would be the key assumptions that -- that were highlighted for him. It -- it was probably not as pointed conversation that we probably will evolve to through time. It was more, Does this seem reasonable, as opposed to, Is this something you are prepared to live with. But it really come -- came out of the Corporation's forecasting process, the Corporation's operational needs, and was vetted to an extent with the bond manager.

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

MS. HEATHER REICHERT: No, I -- I would not say that what we are doing this year is different than what we were doing in past years. In past years we believed that keeping the asset duration and the claims liability duration within the two (2) year, plus or minus, band width was effectively sufficient immunization to the Corporation against the -- the impact of changing interest rates. And we never included that in our financial model forecast. We assumed that they would be very closely immunizing one another, or offsetting one another.

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

So we always were wanting to immunize our self against the changing interest rates. Now we can do it on a much more sophisticated and factual basis with the financial model that we have.

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

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

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

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

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

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

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

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

MS. CANDACE GRAMMOND: So when -- Ms.

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

MS. MARILYN MCLAREN: Right.

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

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

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

MS. MARILYN MCLAREN: Well, there's a cost to perfectly matching at this point, right. If -- if we were to just, you know, ask the bond manager to, you know, reconstruct the portfolio to a hundred percent match, that -- we probably, through time, would either need bigger rate increases or we would not have the excess money that -- or in those outer years right now.

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

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

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

MS. CANDACE GRAMMOND: Has the Corporation modelled the impact on investment returns and net income based on a perfect match scenario?

(BRIEF PAUSE)

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

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

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

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

(BRIEF PAUSE)

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Can you comment on how the Corporation was able to run that scenario, the 100 percent match scenario, in light of the content of the MUSH bonds within the portfolio?

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

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

(BRIEF PAUSE)

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

(BRIEF PAUSE)

MR. LUKE JOHNSTON: So I'm not sure that is what I was saying, and -- but there's -- right now if you look at the fixed income portfolio, or rather -- I'm probably better quoting what was done in the Rate App.

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

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

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

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

Basic claims do have a longer duration than -- than corporate claims, longer than -- than nine (9) at -- at -- as of the end of last year. So that would be one -- one main reason why they wouldn't be 100 percent immunized for this line of business.

(BRIEF PAUSE)

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

Is that right?

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

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

Are you with me so far?

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

MS. CANDACE GRAMMOND: Sure.

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

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

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

MS. HEATHER REICHERT: That is correct.

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

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

Is that right?

MS. HEATHER REICHERT: Right. Extending the -- the growth over a -- twice as long, yes.

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

MS. HEATHER REICHERT: That is correct.

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

MS. HEATHER REICHERT: It was selected through judgment.

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

MS. MARILYN MCLAREN: Not to put too

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

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

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

Is that right?

MS. HEATHER REICHERT: Yes, it is.

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

MS. HEATHER REICHERT: That is correct.

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

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

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

MS. HEATHER REICHERT: Again, following on what Ms. McLaren said, we used our judgment to choose a scenario of interest rate forecasts that would mitigate the impact of continuing in the way we've always done it, which was the blue line, or taking a -- an absolute pessimistic view of the future or absolute lowest possible forecast of the future by -- by taking only -- well, sorry, by taking the Conference Board of Canada in the first three (3) years and then the lower interest rate in the following two (2).

So the judgment was to take a middle of the road interest rate forecast in order to mitigate the impact of assuming increasing -- high increasing interest rates throughout the period and also not assuming too low of an interest rate by taking the low forecast throughout that five (5) year period.

So it really was a balance to come up with what we deemed to be a -- a best estimate for the GRA.

MS. MARILYN MCLAREN: Right. And in addition to that I would say that, you know, it's really important to note that after the three (3) years there was no impact on the rates that we are applying for here today in this application. It is well outside the rating period after the three (3) years.

I would also say that, you know, just another way to say what Ms. Reichert said, is that it wasn't -- it really wasn't about the Conference Board at that point in terms of the fourth year and the fifth year. It was not being uncomfortable with the slope of that line basically reflecting the slope of the five (5) banks that they've, you know, they've missed through time.

But the way we have mitigated the optimism in the first three (3) years we were not uncomfortable, for the sake of modelling this, given that it's outside the rating period, to return to the slope, but at a much lower level.

MS. CANDACE GRAMMOND: Thank you. Now, I understand that the yield on ten (10) year Government of Canada bonds is just over 2.6 percent as of the end of August 2013.

Would you accept that?

(BRIEF PAUSE)

MS. HEATHER REICHERT: 2.616 percent to be exact.

MS. CANDACE GRAMMOND: Thank you for that precision. Would -- would you ag -- oh, now he's making an actuary versus accountant joke which I shan't repeat. Ms. Reichert, you would agree that

that's up by about seventy (70) basis points over the last six (6) months, since February of 2013?

MS. HEATHER REICHERT: Approximately, yes.

MS. CANDACE GRAMMOND: Whereas the GRA assumption in comparison is in -- of an eighty (80) point -- basis point increase over three (3) years.

Is that right?

MS. HEATHER REICHERT: That is correct.

MS. CANDACE GRAMMOND: Now, based on our earlier discussions, is it fair to say that most of this beneficial effect on Basic net income will be observed in the results of the current year for 2013/'14?

MS. HEATHER REICHERT: Yes, that -- that is correct. Most of it will be seen in the current fiscal year, again depending on what happens between now and the end of the year with interest rates. But if these were to hold, then most of this bene -- well, all of this benefit would be seen in -- in the '13/'14 fiscal year.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: And to the extent that net income goes up, the Basic net income goes up. Basic retained earnings also go up by the same amount?

MS. HEATHER REICHERT: With respect to that particular aspect? Yes.

MS. CANDACE GRAMMOND: So if fifty (50) basis points of upward movement in interest rates is worth about $22 million, as we saw earlier...

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Just a moment, Madam Chair.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Thank you, Ms. Reichert. I think we've been doing the same math at our respective tables. And, of course, I'm referring to the royal 'we', Mr. Pelly and myself. So going back just for a moment to Table 1.1. We had a discussion earlier in the evidence about a change to the net impact column.

Can you tell us, based on those

changes, what the net inco -- or the net impact rather of 22.4 million becomes if we make the -- the table purely relative to Basic?

MS. HEATHER REICHERT: My calculation is it becomes about twenty-seven point seven (27.7) favourable.

MS. CANDACE GRAMMOND: Thank you. And ours is the same. So with that, say, $27.7 million number in Table 1.1, if that is the net impact of a fifty (50) basis point of upward movement in interest rates, then would we expect the actual seventy (70) basis point upward movement so far in the current fiscal year to contribute to about $38.8 million of Basic net income?

MS. HEATHER REICHERT: I am told by people a lot smarter than I am that it's not entirely linear, so it would be more than twenty-seven point seven (27.7), but it's not proportionateley more than twenty-seven point seven (27.7).

Am I correct?

(BRIEF PAUSE)

MS. HEATHER REICHERT: Okay, so I am told that if you were to do it proportionately you would come up with 39 -- 39 million impact. And it would not exactly be 39, it would be something less than that, but it would be close thereto, I'm told.

MS. CANDACE GRAMMOND: Thank you. Okay, I'm going to ask you then to go to PUB/MPI Pre-ask 2. And I'll give you the exhibit number.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: So this is MPI Exhibit 1 dash -- pardon me, Exhibit 11-2. We entered all of the Board pre-asks as Exhibit 11, and then with sub-exhibit numbers. So this is PUB/MPI Pre-ask 2, Exhibit 11-2. And I'll wait to ensure that the panel has those pre-asks in front of it.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Okay. So if everyone has that exhibit I will ask you to go the table in response to (b), which is on page 2. So in essence the bottom half of page 2.

This table, as I understand it, shows various bank forecasts and the global insight forecast updated to reflect the most recent information available at the time of the response, which was last week.

Is that right?

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

MS. CANDACE GRAMMOND: And any of the bank forecasts that were prepared on an end-of-period basis were adjusted and shown in this table on an average period basis?

MS. HEATHER REICHERT: That's correct.

MS. CANDACE GRAMMOND: Does the Corporation have any concerns with respect to this adjustment to a consistent average period basis?

MS. HEATHER REICHERT: No, not overly. We -- we don't have any concerns.

MS. CANDACE GRAMMOND: Now, it's been mentioned earlier in this hearing that the Public Utilities Board has adopted an approach to the selection of interest rate forecasts for another utility that addresses the risk of optimism in the bank forecast by using the median forecast after eliminating the highest forecast value in each forecast period.

I understand that the last column in this particular table, that is the bottom table on page 2, has been prepared on this basis, at least to the end of 2014?

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

MS. CANDACE GRAMMOND: And beyond 2014 the last column reproduces the Global Insight ,which is the only forecast available beyond 2014 from those sources.

MS. HEATHER REICHERT: Correct.

MS. CANDACE GRAMMOND: Would you agree with the observation that the global insight forecast for Quarter 4 of 2014 is the second lowest from among the six (6) forecasts shown?

MS. HEATHER REICHERT: Yes, I would agree.

MS. CANDACE GRAMMOND: And that's of course the 3.01 percent? Now, still within this pre-ask, I would ask you to turn to the second-last page.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: So it's labelled in the right-hand -- upper right-hand corner, "PUB/MPI Pre-ask 2C Part 2," and it's numbered page 5.

MS. HEATHER REICHERT: I have it.

MS. CANDACE GRAMMOND: Okay. Does the Board have it? So page 5, which is the second-last page of this document.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Thank you. Now, can you confirm that this particular document shows the pro forma income statement forecasts reflecting the interest rate forecast that we were just discussing in combination with a 1.8 percent overall rate increase taking effect March 1st, 2014?

MS. HEATHER REICHERT: Yes, I can.

MS. CANDACE GRAMMOND: Thank you. Now, looking to the bottom line of this exhibit, the net income or loss line from operations, we see a positive net income of just under 1.6 million in 2014/'15, and about 6.7 million in 2015/'16. And those items of net income follow a net income of just under 50 million in the current year.

Is that right?

MS. HEATHER REICHERT: Yes, it is.

MS. CANDACE GRAMMOND: And based on the Corporation's approach that we've talked about in terms of how it calculates a breakeven, would the same rate increase still be applied for under this forecast?

MS. HEATHER REICHERT: Given in this situation that the average is 4 -- 4 million average of the two (2) rating years. It -- it's debatable. That's about a half a percent. So it might -- if this were our forecast, it might have reduced the one point eight (1.8) down a half -- a half a point to one point three (1.3).

MS. CANDACE GRAMMOND: Thank you. So I'm going to ask you then to turn the page to page 6 of the same document. So just flip -- flip the page. This is a recast of PF-3, which is a retained earning schedule for Basic. And if we look at this, again, in the scenario that we've been discussing, we see the Basic retained earnings exceeding 190 million by the end of 2013/'14 and growing thereafter.

Is that right?

MS. HEATHER REICHERT: Sorry, did you say 180 million by the end of --

MS. CANDACE GRAMMOND: I -- I said exceed 190 million -- or I meant to say it; maybe I didn't -- exceed 190 million by the end of the current fiscal year and then increase thereafter. If I'm looking at the one ninety-one, o-four-two (191,042).

MS. HEATHER REICHERT: Oh, okay. Sorry, yes, I -- I see that number now.

MS. CANDACE GRAMMOND: Thank you. Now, I apologize for jumping around, but it's necessary. I'm now going to ask you to go back to page 3, so same document, but let's leave page 6 and go back to page 3. This is a recast of PF-1, pro forma 1, in the scenario of a 1 percent rate increase. And the forecasts, in terms of net results, are similar to what we just reviewed.

Is that right?

MS. HEATHER REICHERT: Yes, I believe so.

MS. CANDACE GRAMMOND: Again, we see in current year net income of just under 50 million ;for the year of the Application, we see a net loss of just under 1.7 million; and then we see net income for 2015/'16 of four hundred and twenty-seven thousand (427,000).

Is that right?

(BRIEF PAUSE)

MS. HEATHER REICHERT: I'm sorry, Ms. Grammond, can you just repeat that?

MS. CANDACE GRAMMOND: Sure. So I'm on page 3.

MS. HEATHER REICHERT: Yep.

MS. CANDACE GRAMMOND: And this is the scenario that includes a 1 percent rate increase as opposed to what the Corporation has applied for. So we see for the current year, 20 -- ending in 2014 a net income of just under 50 million, forty-nine, five-seven-three (49,573).

MS. HEATHER REICHERT: I'm not on the right page then.

(BRIEF PAUSE)

MS. HEATHER REICHERT: Yes, I can see it.

MS. CANDACE GRAMMOND: Okay. So we're -- we're in Pre-ask 2, page 3. Is that what you have in front of you?

MS. HEATHER REICHERT: Yes, the electronic version that I'm looking at has what you're referring to.

MS. CANDACE GRAMMOND: Okay.

MS. HEATHER REICHERT: I think I just have a -- a photocopy issue.

MS. CANDACE GRAMMOND: Okay. So this is in the scenario we see in the top left-hand corner, "PF-1, 1 percent, Part B," just to make sure that we're looking at the same thing?

MS. HEATHER REICHERT: Yes.

MS. CANDACE GRAMMOND: So we see -- just to -- so that we're clear, so current year ending 2014, this -- in this scenario forecasts a net income of just under 50 million. In the year of the Application we see a net loss of just under 1.7 million. And then for 2015/'16 we see a net income of four hundred and twenty-seven thousand (427,000)?

MS. HEATHER REICHERT: Correct.

MS. CANDACE GRAMMOND: Okay. Now, based on the Corporation's regular approach to breaking even and how that's calculated, would you say that a 1 percent overall rate level increase is justified under this forecast?

MS. HEATHER REICHERT: Generally speaking, yes.

MS. CANDACE GRAMMOND: Thank you. I'm going to ask you, then, to move to Pre-ask 3. So it's still part of Exhibit 11, MPI Exhibit 11, but now it's 11-3, rather than 11-2.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Does everyone have Pre-ask 3? Okay. So would you agree that what we see here -- and this is only a two (2) page document, double-sided.

Would you agree that this is a summary of various forecasted amounts under each of a number of different interest rate change and rate level change scenarios that have been requested by the Board through the IR and pre-ask process?

MS. HEATHER REICHERT: Yes, I would.

MS. CANDACE GRAMMOND: And is it fair to say that the different interest rate forecasts underlying these scenarios, like the interest rate forecast that's underlying the GRA, each represents a distinct possible in -- outcome for Basic, but that all of the scenarios are not equally likely?

MS. HEATHER REICHERT: Yes, I can agree with that.

MS. CANDACE GRAMMOND: Now, I note that the forecasted levels of Basic net income for the year of the application, 2014/'15, range from a low of $21.5 million loss to -- and that's at 3B -- to a high of $10.1 million income. That's at 2A on -- or under

4B, but at 2A on the second page, compared with the GRA forecast of 7.5 million.

Can you tell me -- and -- and if you want to take this as an undertaking, that's fine -- are there any scenarios on this list which the Corporation would be con -- would consider to be extreme outliers?

(BRIEF PAUSE)

MS. HEATHER REICHERT: We can take that as an undertaking.

MS. CANDACE GRAMMOND: And the second part of that, so which scenarios in this document would it consider to be extreme outliers, if any? And if the Corporation does so identify an extreme outlier or more than one (1), why?

MS. HEATHER REICHERT: Yes, we will.

--- UNDERTAKING NO. 25: MPI to advise which scenarios under 2A the Corporation would consider to be extreme outliers and why

MS. HEATHER REICHERT: I would just like -- while we -- we are looking at this summary, I think it -- it really displays what we have been discussing over the last several days, and quite a bit today. This shows how much volatility there is in the results of the Corporation depending on what, in fact, does happen with interest rates, because all of these different scenarios are assuming different growths or different interest rates for the rating period. So you can see from what Ms. Grammond already highlighted, the impact can be quite significant to the Corporation depending on what happens with interest rates. So this, I think, just highlights that very, very well.

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Thank you. Would you agree that the accuracy of Basic net income forecasting could be improved if Basic net income could be made less interest rate sensitive?

MS. HEATHER REICHERT: I'm hesitating. I think that the volatility of the Basic income forecast would -- it would be less volatile if the impact of interest rates weren't as significant. I think that the forecast itself is -- is improved by the underlying financial model that we have that is more robust and able to -- able to handle different assumptions. So the -- the volatility of the forecast, yes, that would be helped if there wasn't in -- there wasn't the interest rate volatility that we are currently forecasting.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: So what steps could be taken to make the forecasting of net income in Basic less interest-rate sensitive?

MS. HEATHER REICHERT: I think we have talked about that here already at the hearings. If we were more closely duration matched between our bonds and our liabilities, that would reduce the impact of any interest rate movement on the forecast for the -- for the Basic Program.

But as we have also said, if we were to move immediately to being duration matched, that would then not allow the Corporation to benefit from increasing interest environment with our current duration mismatch being of benefit to us.

MS. CANDACE GRAMMOND: So in the future, would it be worth looking at decreasing the mismatch even if the ultimate goal isn't to immunize a hundred percent?

MS. HEATHER REICHERT: I do believe it is something that is worthwhile to look at. And it is something that we are looking at and can come to the Board later this week or early next week and provide them with some information of what that would look like if we were to do it in the very near term.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Thank you. Madam Chair, I have a fairly short section that I think I can complete within about ten (10) minutes. So with the Board's permission, I'd proceed with that. Thank you.

So for the purposes -- and this is to do with the break-even objective that we've been talking about and how the Corporation assesses that. Can you tell us how the Corporation measures its success in terms of meeting the break-even objective?

MS. MARILYN MCLAREN: I -- I think for sort of assessing -- well, I guess both in terms of -- through this process with the PUB through time, both are you in the ballpark in terms of forecast compared to actual and what would constitute breakeven, I -- I think we have generally talked about a range of about $20 million, plus or minus 10 million.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: So just to clarify then, what the Corporation is looking at prior to filing the rate application, or deciding what is going to be applied for, it looks at various scenarios. And in assessing the two (2) year period, is it looking at the average net income or loss, or the total net income or loss over the two (2) years?

MS. HEATHER REICHERT: I -- I can clarify. I -- I believe that Ms. McLaren was responding to your question on an annual finan -- like actual financial results. How we look at that relative to what we budgeted, and do we consider being within 10 million on a actual basis from our budget, plus or minus, as -- as being pretty close to making -- making budget. And we do.

For the purposes, however, of rate setting we do the pro formas. We do -- without assuming any type of rate increase. We do the -- the forecasted pro formas and we look at the two (2) rating years. We take the average of the net incomes on -- in those two (2) rating years. If they are a negative and a positive then they're netted.

So we take that average, add them together, divide by two (2), and based on that if, for instance, sim -- simplistically, that average was 4 million negative in the forecasted pro formas, and 8 million represents 1 percent rate increase, then we would apply for a .5 percent rate increase that would, essentially, over the two (2) rating years generate sufficient income to offset that negative forecast of on average 4 million. So for rating purposes we try to get as close to net zero between the two (2) rating years as possible.

MS. CANDACE GRAMMOND: Thank you. Let's just talk a little bit for a moment about the rationale of using the two (2) years as to -- as opposed to some other period of time. Is that a reflection of the fact that it takes in essence two (2) full years for the impact of a rate change to be fully realized because of staggered renewals?

MS. HEATHER REICHERT: Yes.

MS. CANDACE GRAMMOND: So would you agree that the results for the year following the test year in the current GRA, so in our case 2015/'16, will also be influenced by the proposal and ultimate Board decision arising from the next GRA.

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

MS. CANDACE GRAMMOND: This would seem to suggest that while both the test year and the year following are important to assessing fit with the Basic break-even objective, greater weight should somehow be accorded to the net income in the test year since this GRA is basically the last chance to impose action that influences the outcome for the test year, whereas for the subsequent year we're going to be having another discussion a year from now.

What are your thoughts on that?

MS. HEATHER REICHERT: I don't -- I -- I don't agree. The reason I -- I don't agree is both years are -- are critically important. We come forward asking for the rate increase for the year starting March 1st of 2014. That 1.8 percent increase, we're only effectively going to achieve .9 percent in the test -- the test year, as you refer to it, and then the -- the additional .9 percent in the -- the following year.

So both years are equally important because the revenue that we are wanting to generate from this rate proposal will equally impact both the test year and the '15/'16 year. So we -- and that's why we average them, because we consider them to be equally important to establishing the appropriate rate for the coming year.

MS. CANDACE GRAMMOND: Thank you. I just want to put an example forward on the same issue to -- to explore a little bit further.

So let's say that the Corporation is choosing between two (2) forecast scenarios identical in every respect except for the proposed rate.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: So just to clarify then, what the Corporation is looking at prior to filing the rate application, or deciding what is going to be applied for, it looks at various scenarios. And in assessing the two (2) year period, is it looking at the average net income or loss, or the total net income or loss over the two (2) years?

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MS. CANDACE GRAMMOND: Thank you. I just want to put an example forward on the same issue to -- to explore a little bit further.

So let's say that the Corporation is choosing between two (2) forecast scenarios identical in every respect except for the proposed rate level change for the purposes of putting one (1) forward at the GRA.

The first scenario forecasts net income of a loss of 1 million in the test year and an income of 1 million in the year following. So for a -- a two (2) year total net income of zero.

The second scenario forecasts net income of zero in the test year and 2 million in the year following for a two (2) year total of 2 million in net income, or an average of 1 million if you looked at the two (2) years together.

So what would the Corporation's thought process be for deciding between those two (2) scenarios?

(BRIEF PAUSE)

MS. MARILYN MCLAREN: It might be, Wow, did those two (2) scenarios ever come close together. I -- I would like us to avoid going down a rabbit hole on this. You know, I mean I -- so maybe we can figure out a little more specifically what it is -- where you're heading and what you're suggesting.

I mean, the reality is this is the last chance to have an impact on '14/'15, but only half of what happens in '14/'15 will be affected by the dec -- this decision on rates. Basically, you know, half the decision on what happens in '14/'15 will be driven by what's happening this year in '13/'14. You know, and we need to talk about the fact that we are here not changing our forecast for the year -- rarely changing the forecast for the year.

So, I mean, if we have -- if we're looking at something that tells us we're going to break even in the test year and then make money, I'm more comfortable in sort of just talking in those terms without sort of the zeros, and the ones, and the twos, because they're such small numbers, right. So, I mean if you're looking at breaking even and then making a lot of money in the '15/'16 year, materially, significantly more profitable, I -- I cannot recall that that has happened and influenced our application.

But if it was to happen, some of the things that we would think about is how likely is that '15/'16 to actually transpire? If we're really going to break even with a forecast that is very -- on the same basis in both of the test years -- and we really do tend to think of them as both of the test years inside MPI, If we understood why and we believed that that was something that was going to continue, we may very well apply for a rate decrease in the '14/'15 year even if it was going to break even and we were looking at a large increase in the subsequent year.

But if it was somewhat uncertain, if it

was based on something like our -- our best estimate of interest rates, or potentially the -- the cost of something -- some sort of new coverage or something like that, then -- then we may behave differently.

But having really different results in an unexplainable kind of way in the two (2) years is -- it's not something that's happened to a significant extent. You know, I mean, you could -- rather than your zero, and your 1, and your 2, you could talk about, you know, this year we're going to -- this year we lose a bit, next year we make a bit, or -- or the -- meaning '14/'15, '15/'16, so that -- that does not drive a decision one (1) way or the other based on which is negative and which is positive.

They're both in the ballpark. We understand what they are and we do really think of it, to the extent that's reasonable, in our view as two test years.

MS. CANDACE GRAMMOND: Thank you, Madam Chair. That completes that section. So just for everyone's knowledge, I do have a little bit left, probably somewhere between half-an-hour and an hour, I'm guessing, that I'll pursue tomorrow morning. And then I'll turn the mic over to My Friend Mr. Williams.

THE CHAIRPERSON: Ms. Kalinowsky...?

MS. KATHY KALINOWSKY: Thank you very much. I know Ms. Reichert has a transcript in her hand and she just wanted to read something in that was mentioned in direct-examination, and it was in response to a question that I posed to her in the first day. And it was a question that pose -- garnered a lot of interest from the Board members and it was with respect to the interest rate forecast and what were the options for the Public Utilities Board. So we've just gone through a whole bunch of different scenarios of, you know, different types of interest rate forecasts. So I'll ask Ms. Reichert to read in her response there. Thank you.

MS. HEATHER REICHERT: Thank you. So the options for -- for the Board:

"Essentially, the Public Utility Board will need to decide to what extent, if at all, they will substitute the Corporation's judgment for their own. If interest rates continue to be more favourable than our forecast, and the PUB approves the rate increase, then the RSR will be returned to the DCAT-driven target more quickly.

If interest rates continue to be
higher than our forecast, and the
Public Utility Board disallows any
rate increase, then it will take
longer to rebuild the RSR. And if
interest rates prove to follow the
recent history of increases and
decreases, and the Public Utility
Board disallows any rate increase, I
do expect that next year we will be
here asking for both a rate increase
and an RSR building surcharge."

MS. KATHY KALINOWSKY: So thank you. And can you give the transcript page number for that?

MS. HEATHER REICHERT: I'm sorry. Yes, I can. It is transcript from 9/24/2013, page 69.

MS. KATHY KALINOWSKY: Thank you.

THE CHAIRPERSON: Okay. Thank you very much. That concludes our hearing for today. And we will reconvene tomorrow at 9:30. Thank you.

--- Upon adjourning at 4:02 p.m.

Certified correct,

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Cheryl Lavigne, Ms.