



“When You Talk - We Listen!”



MANITOBA PUBLIC UTILITIES BOARD

Re: PUBLIC HEARING  
RE: MANITOBA PUBLIC INSURANCE  
GENERAL RATE APPLICATION  
FOR THE 2013/14 INSURANCE YEAR

Before Board Panel:

Regis Gosselin - Board Chairman  
Karen Botting - Board Member  
Anita Neville - Board Member

HELD AT:

Public Utilities Board  
400, 330 Portage Avenue  
Winnipeg, Manitoba  
October 2, 2012  
Pages 898 to 1018

1		APPEARANCES	
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3			
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5			
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7			
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1 --- Upon commencing at 9:33 a.m.

2

3 THE CHAIRPERSON: Good morning,  
4 everyone. I believe we're ready to begin today's  
5 proceedings. We have some matters to attend to before  
6 we start. I believe we have an exhibit from MPI.

7 MS. KATHY KALINOWSKY: Yes, I've handed  
8 out Undertaking number 9, which is a report regarding  
9 the problems intersections in the city. And there's a  
10 list there that I'm sure that Board member and others  
11 will be looking at as -- before they drive home from  
12 the hearing today. But I would suggest that it be  
13 marked as MPI Exhibit number 12.

14

15 --- EXHIBIT NO. MPI-12: Response to Undertaking  
16 number 9: report regarding  
17 the problem intersections  
18 in the city

19

20 MS. CANDACE GRAMMOND: Thank you, Mr.  
21 Chairman. I think we can turn it over to Mr. Williams.  
22 I know he has some exhibits as well that he'll enter,  
23 and then I assume he'll start his cross.

24

25 MPI PANEL, RESUMED:

1 MARILYN MCLAREN, Resumed

2 HEATHER REICHERT, Resumed

3 LUKE JOHNSTON, Resumed

4

5 CROSS-EXAMINATION BY MR. BYRON WILLIAMS:

6 MR. BYRON WILLIAMS: Yes. Good

7 morning, Mr. Chair, and members of the panel. And with  
8 -- with me again is Ms. Desorcy. She's found her way  
9 over from the Bipole 3 hearing and, I think, is very  
10 glad to be at the Public Utilities Board.

11 We have four (4) exhibits to -- to  
12 introduce. One should be the -- and does the panel  
13 have them be -- yes. One should be a fairly thick  
14 document titled, "MPI 2013 General Rate Application  
15 Excerpts from the Record," and we would ask that that  
16 be marked as Exhibit number 5.

17

18 --- EXHIBIT NO. CAC/MANITOBA-5: Document titled, "MPI  
19 2013 General Rate  
20 Application Excerpts  
21 from the Record"

22

23 MR. BYRON WILLIAMS: And those are  
24 excerpts from the record, so I -- I certainly have not  
25 sought the -- I don't see any issue with these. Next,

1 there is a one (1) page sheet to -- to teach both Ms.  
2 Desorcy and Mr. Williams about discount rates, and it's  
3 called, "The Simple Illus -- Illustration of the Effect  
4 of a 1 Percent Increase in Interest Rates."

5 We would suggest this is -- this be  
6 marked as CAC/Manitoba exhibit number 6. We've shared  
7 it with My Learned friend, Ms. Kalinowsky, and I do not  
8 believe she has any objections, although not -- she --  
9 she may be looking -- okay.

10

11 (BRIEF PAUSE)

12

13 MR. BYRON WILLIAMS: I believe we've  
14 shared some copies, but some may have disappeared.

15

16 (BRIEF PAUSE)

17

18 MR. BYRON WILLIAMS: Ms. Kalinowsky, I  
19 -- I apologize for my inaccurate counting. So we'd  
20 suggest that be marked as Exhibit number 6, Mr. Chair.

21

22 --- EXHIBIT NO. CAC/MANITOBA-6: Document titled, "The  
23 Simple Illustration  
24 of the Effect of a 1  
25 Percent Increase in



1 Interest Rates."

2

3 MR. BYRON WILLIAMS: The -- the next  
4 document should be titled, "Addendum to MPI Rate Risk  
5 Management in the RSR." This is actually a document  
6 prepared by doc -- Professor Simpson. We shared it  
7 with MPI and -- and Board counsel quite some time ago.

8 It's really an addendum to Mr. --  
9 Professor Simpson's evidence. It will be used to  
10 assist the discussion either today or -- or tomorrow as  
11 well and we would suggest that be marked at CAC Exhibit  
12 number 7.

13

14 --- EXHIBIT NO. CAC/MANITOBA-7: Document titled,  
15 "Addendum to MPI Rate  
16 Risk Management in  
17 the RSR"

18

19 MR. BYRON WILLIAMS: And finally, there  
20 should be a document which in the upper left-hand  
21 corner is titled, "Accident Benefits Others Indexed."  
22 Again, it's a document we've shared with -- with MPI  
23 and we would suggest that be marked as CAC Exhibit  
24 number 8.

25

1 --- EXHIBIT NO. CAC/MANITOBA-8: Document titled,  
2 "Accident Benefits  
3 Others Indexed"  
4

5 MR. BYRON WILLIAMS: And I -- our  
6 clients do appreciate the -- the cooperation of  
7 Manitoba Public Insurance in introducing those  
8 documents.

9 Mr. -- Mr. Chairman, and members of the  
10 Board, just a quick outline today of some of the things  
11 we're discussing. I -- I realize we have a short day.  
12 A -- a lot of them will -- will relate to the -- the  
13 work of Mr. Johnson. Some will go to Mr. -- Ms.  
14 Reichert, and few may go to Ms. McLaren. I'm sure  
15 she'll -- she'll have her say before the -- the day is  
16 over.

17 Our client is part of her -- their  
18 organization's ongoing work with both focus groups and  
19 their advisory groups, has a number of questions about  
20 road safety, some of which she woul -- she would like  
21 me to ask today. So we are going to go a bit out of  
22 order of the -- perhaps the -- the logic of the cross-  
23 examination.

24 And finally, Mr. Chair, we're mindful we  
25 sat through the excellent cross-examination of My

1 Learned Friend Ms. Grammond. We're always mindful of  
2 avoiding duplication. There will be times when we do  
3 cover some of the same area, but hopefully to a -- to a  
4 different end or to enrich the record rather than to  
5 merely duplicate it.

6

7 CROSS-EXAMINATION BY MR. BYRON WILLIAMS:

8 MR. BYRON WILLIAMS: Mr. Johnston,  
9 perhaps we'll start with you. And I'd like to start by  
10 discussing with you the relationship between the review  
11 of claims liabilities and the Corporation's forecast of  
12 claims incurred for the purpose of -- of rate setting.

13 Sound okay, Mr. Johnston?

14 MR. LUKE JOHNSTON: Yes, that's --  
15 that's fine.

16 MR. BYRON WILLIAMS: It's kind of what  
17 you do.

18 MR. LUKE JOHNSTON: That's true. We  
19 did -- we touched on this a little bit last week. But  
20 in the review of claims liabilities, we are looking at  
21 prior years' claims and we're making an estimate on the  
22 ultimate cost of those claims in prior years.

23 Of course, when we're forecasting, a --  
24 a very important, if not the most important aspect, is  
25 the history of claims. So if we are forecasting PIPP,

1 for example, a -- a good starting point is the  
2 historical PIPP experience. And then we'll, of course,  
3 supplement that with field information from the bodily  
4 injury division.

5                   There may be reasons why we expect  
6 different trends than in the past or different claims  
7 settling patterns, et cetera. But again, the  
8 historical expe -- experiences, I would say, carries  
9 the most weight in forecasting.

10                   MR. BYRON WILLIAMS: Thank you, Mr.  
11 Johnston, and -- and certainly from your answer, I take  
12 it that the -- you would agree that the evaluation of  
13 policy liabilities really serves as the groundwork for  
14 the financial forecast.

15                   Is that correct, sir?

16                   MR. LUKE JOHNSTON: Yeah, I think  
17 that's -- that's fair. It's -- it's -- as I mentioned,  
18 it carries the majority of the weight, the -- our  
19 historical experience.

20                   MR. BYRON WILLIAMS: And to take that  
21 one step further, if we look at the estimations of  
22 incurred but not rela -- not reported, IBNR, really,  
23 your forecasts are inextricably linked to the IBNR  
24 review of liabilities.

25                   Would that be fair, sir?

1 MR. LUKE JOHNSTON: Yeah, I would -- I  
2 would say that's -- that's fair, if -- if there was an  
3 assumption knowingly -- perhaps not knowingly  
4 overstated in the liability review, that would flow  
5 through, a large extent, into our forecast.

6 So if -- if we had an assumption that,  
7 for example, PIPP claims were going to grow by 2  
8 percent a year, and then we later changed that to 1  
9 percent a year, that would obviously flowthrough to our  
10 PIPP forecast.

11 MR. BYRON WILLIAMS: To put it in terms  
12 that even a humble lawyer can understand, if your basis  
13 overstated, you'll -- there's a material risk you'll  
14 also overstate the forecast going forward?

15 MR. LUKE JOHNSTON: Yes, that's true.  
16 If -- if we have a forecast coming out of the liability  
17 review it only makes sense to -- to follow the -- the  
18 same pattern. If -- if say the -- say the Corporation  
19 didn't agree with every aspect of the appointed  
20 actuaries review. It likely wouldn't be appropriate  
21 for us to make a forecast much lower than -- than the  
22 assumptions that -- that he's used in his report.

23 MR. BYRON WILLIAMS: Now, this question  
24 can go to anyone on the panel, so, Ms. Reichert or Ms.  
25 McLaren, if you're feeling left out, no worries, pop

1 right in.

2 But wi -- without asking you to  
3 elaborate in particular, I would ask the MPI panel to  
4 confirm that you recall that there was considerable  
5 discussion on day 1 of the hearing regarding the role  
6 of both the external actuary and the external auditor.

7 Do you recall that in your -- in your  
8 direct evidence?

9 MR. LUKE JOHNSTON: Off -- off the top  
10 of my head I -- I don't recall, but there's -- there's  
11 definitely a role between those -- those two (2)  
12 individuals or bodies.

13 MR. BYRON WILLIAMS: Well, I'll suggest  
14 to you, Mr. Johnston, that whether it was in your  
15 evidence or -- or in Ms. Reichert's, and indeed in  
16 both, that one of the important messages you were  
17 sending was that there are in -- checks and balances in  
18 the forecasting process, and that those checks and  
19 balances include both the external actuary and the  
20 external auditor.

21 Would that be fair?

22

23 (BRIEF PAUSE)

24

25 MR. LUKE JOHNSTON: Yeah, that's --

1 that's fair. With respect to the liability review,  
2 there's involvement of the auditors and the appointed  
3 actuary. And then the DCAT also includes the appointed  
4 actuary review.

5 MR. BYRON WILLIAMS: And I'm just  
6 trying to recall, but perhaps even the cost allocation  
7 methodology?

8 MS. HEATHER REICHERT: Yes, that's  
9 correct. The external auditor does -- does do an audit  
10 of the Basic financial statements, which embodies the  
11 cost allocation. And we did ask the external actuary  
12 to do additional work this year to provide more comfort  
13 to the PUB.

14 As well, the external auditor does have  
15 their own actuary that looks at, in the process of  
16 auditing, our corporate and Basic financial statements,  
17 looks at what we are establishing for -- for actuarial  
18 estimates in the financial statements.

19 MR. BYRON WILLIAMS: I thank you for  
20 that, Ms. Reichert. And the panel, I do not believe,  
21 needs to turn there, but if you're ever bored and are  
22 looking for a helpful description of what the -- the  
23 roles of the external actuary and the external auditor  
24 perform, PUB-1-18 is really a very good description.

25 And, Mr. Johnston or -- or Ms. Reichert,

1 probably to you, Mr. Johnston, in terms of the -- the  
2 role of the external valuation actuary, would it be  
3 fair to say that a central document prepared in support  
4 of this Rate Application is the review of the  
5 assumptions and methodologies underlying the review of  
6 policy liabilities based on figures as of October 31st,  
7 2011?

8 MR. LUKE JOHNSTON: I believe the  
9 question was: Was that an -- the key role of the  
10 appointed actuary? Sorry.

11 MR. BYRON WILLIAMS: The question  
12 wasn't very well asked, Mr. Johnston, so let's try that  
13 one again. Hopefully I'll do better. In terms of the  
14 Rate Application -- let's leave the external actuary  
15 out of this for a second.

16 In terms of the Rate Application, a -- a  
17 central foundational document is the actuarial report  
18 on MPI, the -- the universal compulsory automobile  
19 insurance as of October 31st, 2011, correct?

20 MR. LUKE JOHNSTON: Yes, and what makes  
21 that one more important than February's is the -- we do  
22 the October -- the as at October 31 review in advance  
23 of year end, so we have more time to review the  
24 assumptions prior to year end. Once -- once year end  
25 comes, we need to literally just produce a report



1 within a few weeks. So we want more time, which is why  
2 we do that earlier in the year.

3 MR. BYRON WILLIAMS: And that report is  
4 prepared by the external actuary, using analysis  
5 provided by the Corporation's internal actuarial  
6 department, as well as his own -- own staff, correct?

7 MR. LUKE JOHNSTON: Yes, the actual  
8 report is prepared by the external actuary. The -- the  
9 work is largely done in house, and we send an initial  
10 draft to the appointed actuary. And then discussions  
11 ensue on all the assumptions. The appointed actuary  
12 also has their own software in house that they use, but  
13 I don't review the -- that -- the output from -- from  
14 their software.

15 MR. BYRON WILLIAMS: I apologize to the  
16 court reporter. You mentioned, as well, the actuarial  
17 report on universal compulsory insurance as of February  
18 29th, 2012.

19 And, again, that report is prepared by  
20 the external actuary with the assistance of MPI,  
21 correct?

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

24 MR. BYRON WILLIAMS: And as Ms.  
25 Reichert may have already mentioned, both of these

1 documents -- the review of policy liabilities as at  
2 October 31st, 2011, and the review of policy  
3 liabilities as at February 28th or 29th of 2012 -- are  
4 given to the external auditors, KPMG, to be reviewed by  
5 their consulting actuary, correct?

6

7

(BRIEF PAUSE)

8

9

MR. LUKE JOHNSTON: Yes, that's  
10 correct. They -- they review those reports and they  
11 often have interactions with the appointed actuary,  
12 which I don't know the nature of all of them, but they  
13 -- they do.

14

MR. BYRON WILLIAMS: So, in essence,  
15 the review of policy liabilities, which forms such a  
16 central el -- element of the forecast of claims  
17 incurred, is signed off on by both the external actuary  
18 and the auditor, correct?

19

MR. LUKE JOHNSTON: Yeah, that's  
20 correct.

21

MR. BYRON WILLIAMS: And if I were to  
22 go back any year in recent history, I would find that -  
23 - that same pattern repeating, with the review of  
24 policy liabilities being prepared by the external  
25 actuary and reviewed by the external auditor, with the

1 assistance of his actuarial consultant, correct?

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

4 MR. BYRON WILLIAMS: For the be --  
5 benefit of the MPI witnesses and also for the panel,  
6 CAC-5 is excerpts from the record. And you'll see some  
7 messy handwriting up in the right hand -- numbering in  
8 the top right-hand corner. So we'll try and work off  
9 of that pagination for these documents.

10 Mr. Johnston -- and again, you have had  
11 some discussion with Ms. Grammond, in terms of  
12 forecasts of claims incurred, so we're not going to  
13 spend a long time here. But we are going to spend a  
14 bit of time on this document, which is at page 1, in  
15 the top right-hand corner of CAC Exhibit 5.

16 And you'll agree with me that a -- that  
17 it appears to be an attachment to CAC-1-56, the First  
18 Round Information Request, correct?

19 MR. LUKE JOHNSTON: Correct.

20 MR. BYRON WILLIAMS: And if were to try  
21 and to describe verbally what we see as we move in this  
22 document from left to right, I'll suggest to you that  
23 on the left-hand side we'll see a table titled, "Claims  
24 Incurred."

25 Do you see that, Mr. Johnston?

1 MR. LUKE JOHNSTON: Yes, I do.

2 MR. BYRON WILLIAMS: In the middle, we  
3 have a -- a table titled, "Statistical Measures  
4 Original Projected." Do you see that, sir?

5 MR. LUKE JOHNSTON: Yes.

6 MR. BYRON WILLIAMS: And on the right-  
7 hand side we see a table, "Statistical Measures Revised  
8 Forecast." Is that correct, sir?

9 MR. LUKE JOHNSTON: Correct.

10 MR. BYRON WILLIAMS: Now, Mr. Johnston,  
11 just for a couple of seconds I'd like you to -- direct  
12 your attention to the left-hand side, which is "Claims  
13 Incurred." And just as we again try and familiarize --  
14 orient -- orient ourself to the table, the first column  
15 under claims incurred is simply the insurance year,  
16 correct?

17 MR. LUKE JOHNSTON: That's correct.

18 MR. BYRON WILLIAMS: And the next  
19 column over would be the actual claims incurred in that  
20 particular insurance year. Is that -- is that so, sir?

21 MR. LUKE JOHNSTON: That's correct.

22 MR. BYRON WILLIAMS: And the next  
23 column over is the original projected, correct?

24 MR. LUKE JOHNSTON: Correct. So the --  
25 the original projected in the GRA, so again that would

1 be the 2013/'14 year in this -- this case of this  
2 Application.

3 MR. BYRON WILLIAMS: And then there's  
4 the revised forecast is the fourth column, sir?

5 MR. LUKE JOHNSTON: Correct. And --  
6 and that would be the '12/'13 year in this GRA.

7 MR. BYRON WILLIAMS: And thank you.  
8 You -- you made quite an important point. If I was  
9 trying to look at what -- what the -- the General Rate  
10 Application was based upon I would focus on the  
11 original pro -- projected column.

12 Is that correct, sir?

13 MR. LUKE JOHNSTON: That's correct.

14 MR. BYRON WILLIAMS: So let's just take  
15 an example of that if -- if we might, just to -- to  
16 familiarize ourself with this -- this table. And let's  
17 go down to the insurance year 2009/'10. And we'll see  
18 that the -- moving two (2) columns over, the original  
19 projected claims incurred for that particular year was  
20 roughly 625 million.

21 Would that be correct, sir?

22 MR. LUKE JOHNSTON: Correct.

23 MR. BYRON WILLIAMS: And we see that  
24 the actual was about five hundred and fifteen (515) --  
25 somewhere between 515 and 516 million, correct?

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

3 MR. BYRON WILLIAMS: So we see a  
4 difference between the projection used for rate setting  
5 and the actual of about \$109 million.

6 Is that correct, sir?

7 MR. LUKE JOHNSTON: Yes, that's  
8 approximately correct.

9 MR. BYRON WILLIAMS: And just ballpark,  
10 roughly a variance of roughly 17.5 percent of the  
11 original projection?

12 MR. LUKE JOHNSTON: That's correct.

13 MR. BYRON WILLIAMS: So in essence when  
14 we look at the claims incurred table, it's comparing  
15 forecast claims to actual claims for two (2) forecasts:  
16 the original projection and the revised forecast.

17 That's what it's telling us, correct?

18 MR. LUKE JOHNSTON: That's correct.

19 MR. BYRON WILLIAMS: We're going to  
20 ignore the revised forecast table, but I just want to  
21 make sure that we're on common ground, in terms of the  
22 middle table being statistical measures original  
23 projected.

24 Mr. Johnston, I'll suggest to you that  
25 this table summarizes the forecast errors for the

1 original projection under -- that's essentially what it  
2 does.

3 Would that be fair?

4 MR. LUKE JOHNSTON: That's correct.  
5 There's various measures that are used to -- to  
6 summarize the -- the deviation.

7 MR. BYRON WILLIAMS: And let's take, as  
8 an example, the most recent year of 2011/'12. That's  
9 the -- the bottom year in -- in terms of insurance  
10 years, and focussing again on the middle col -- the  
11 middle table statistical measures of the projected we  
12 see the fourth column over is titled "Prediction  
13 Error."

14 Do you see that, Mr. Johnston?

15 MR. LUKE JOHNSTON: I do.

16 MR. BYRON WILLIAMS: And for the  
17 2011/'12 year, we -- we can see that MPI has calculated  
18 the prediction error for that particular year to be  
19 minus \$35 million.

20 Is that correct, sir?

21 MR. LUKE JOHNSTON: Correct.

22 MR. BYRON WILLIAMS: And essentially  
23 that's the difference between the projection of claims  
24 incurred used for rate setting and the actual results.

25 MR. LUKE JOHNSTON: Yes, that's

1 correct.

2 MR. BYRON WILLIAMS: Moving just one  
3 (1) column over you'll see a heading "Percentage  
4 Prediction Error."

5 Do you see that, Mr. Johnston?

6 MR. LUKE JOHNSTON: I do.

7 MR. BYRON WILLIAMS: And again  
8 focussing on the 2011/'12 year we see the figure of  
9 minus 5.46 percent -- minus five point four-six-one  
10 (5.461).

11 MR. LUKE JOHNSTON: That's correct.

12 MR. BYRON WILLIAMS: You were going to  
13 catch me, weren't you, Mr. Johnston?

14 MR. LUKE JOHNSTON: I was going to say  
15 that's approximately correct, whether the last three  
16 decimals were accurate or not.

17 MR. BYRON WILLIAMS: I could see you  
18 smiling, sir. If we look at the percentage prediction  
19 error, going up to the 2004/'05 year and then  
20 essentially running down to 2011/'12, would you agree  
21 with me that the pattern of signs have -- have been all  
22 negative since 2004/'05?

23 MR. LUKE JOHNSTON: Yes, and -- and I -  
24 - I'm glad you reference 2004/'05 in -- in your  
25 question, because in -- in 2005/'06 is -- is when we



1 made a -- a very significant change to our reserving  
2 practices.

3 In predict -- in particular we created  
4 new reserving guidelines on -- on large claims and we  
5 introduced reserving -- a reserving calculator for case  
6 managers. And it really -- it really drastically  
7 changed our -- how our claims were reported.

8 And pri -- prior to '05/'06, and we  
9 don't have the entire history here, but you'll notice  
10 that at least there were some -- some positive  
11 deviations and -- and with the -- with the best-  
12 estimate forecast, you'd -- you'd expect that sometimes  
13 you'd be above or -- or sometimes you'd be below the  
14 forecast.

15 Aft -- after '05/'06, the results of our  
16 new reserving methodology were showing much more  
17 favourable development than we had estimated in the  
18 liability review, and it -- it took a few years for the  
19 Corporation to recognize this favourable experience.

20 Obviously, you have to be careful with  
21 one (1), or two (2), or three (3) years of data,  
22 whether you're going to assume that that is exactly the  
23 way the new world -- the new state of the world is  
24 going to be when you make a big change in -- in  
25 reserving.

1                   But you will notice that the assumptions  
2 that we were using, in particular to PIPP, were  
3 overstating the forecast fairly consistently. And it  
4 took some -- some fairly substantial changes in those  
5 assumptions to -- to bring the forecast back down to  
6 the -- the smaller deviations that you're seeing now in  
7 '11/'12, both revised and the original forecast.

8                   MR. BYRON WILLIAMS: Thank you for that  
9 thoughtful answer, Mr. Johnston. In terms of the --  
10 you mentioned particular challenges in terms of PIPP,  
11 being P-I-P-P, capitalized. And -- and the -- the  
12 challenges were in both the accident benefit weekly  
13 indemnity line as well as the accident benefit other.

14                   Would that be fair, where the major  
15 challenges were?

16                   MR. LUKE JOHNSTON: Yes, that's fair.  
17 The -- these, as we -- we talked earlier, are the  
18 longer-tail lines, where we're -- where we're dealing -  
19 - although the majority of the claims will close fairly  
20 quickly there are a -- a large dollar portion of claims  
21 that are -- are a result of serious accidents, and they  
22 extend for the life of the claimant.

23                   So these assumptions are obviously  
24 difficult to make, because we don't -- we don't know  
25 exactly what is going to happen with them. And they're

1 -- they're also very sensitive to changes and  
2 assumptions, interest rates, development patterns. So,  
3 yes, we -- weekly indemnity and accident benefits other  
4 indexed, which is mostly personal care, those are the -  
5 - the two (2) key issues with the -- that -- that were  
6 affected by this reserving change I spoke of.

7 MR. BYRON WILLIAMS: And we'll come  
8 back to this point in just one second, Mr. Johnston.  
9 You describe both accident benefits WI and accident  
10 benefit other as longer-tail claims.

11 Did I -- did I hear you correctly, sir?

12 MR. LUKE JOHNSTON: Yes.

13 MR. BYRON WILLIAMS: And one of the  
14 particular challenges that Manitoba Public Insurance  
15 experiences with claims of a longer duration is you  
16 don't have as much evidence, in terms of -- in terms of  
17 evaluating your experience or -- or projecting from  
18 your experience, correct?

19 MR. LUKE JOHNSTON: That's correct.  
20 For these lines, it's -- it's similar to like a long-  
21 term disability type plan, except we really don't have  
22 data on the expected life -- lifetimes of quadriplegics  
23 or brain-injured people, or -- so we're relying a lot  
24 on our own data, and we do have to make assumptions  
25 about the future in terms of how long these -- these

1 claimants are going to live and -- and what type of  
2 payments they're going to receive over their lifetime.

3 MR. BYRON WILLIAMS: So you're talking  
4 about judgments with fairly limited data?

5 MR. LUKE JOHNSTON: Definitely in the  
6 early years of PIPP we had very limited data. When --  
7 when we look at these reports now we're talking about a  
8 tail period, being claims that have open more than ten  
9 (10) years. And we -- we believe that this is the  
10 point in time where all claims are -- are -- all of the  
11 remaining open claims are on for life. There's not  
12 really a significant probability of recovery at that  
13 point.

14 And so we have -- we're starting to get  
15 some experience in this tail period. But, of course,  
16 having fifteen (15) to eighteen (18) years experience  
17 is -- is nowhere close to the potential of thirty (30),  
18 forty (40), fifty (50) years experience that we'll  
19 eventually get.

20 MR. BYRON WILLIAMS: Mr. Johnston, has  
21 Manitoba Public Insurance inquired of its brother or  
22 sister Crown corporations involved in no-fault schemes  
23 in terms of sources of data that -- that they may rely  
24 upon over and above their own internal data?

25 Do you need an example, Mr. -- Mr.

1 Johnston, or are you...?

2 MR. LUKE JOHNSTON: Yeah, I've -- I --  
3 I do meet with SGI fairly regularly. And we have  
4 talked about perhaps trying to combine our experience  
5 and improve on our estimates. Of course, one of the  
6 difficulties is we don't really re -- necessarily  
7 reserve the same way. And that can make it a little  
8 bit difficult to -- to compare the output.

9 We haven't looked in -- at a great deal  
10 at changing our mortality table or -- or our mortality  
11 table is essentially our -- our life expectancy table.  
12 We haven't looked at changing that. We believe the  
13 table we're using does a pretty good job of -- of  
14 estimating lifetimes.

15 And we -- we now have a process in place  
16 that essentially adjusts our tail experience towards  
17 the table over time, so we're -- we're happy with that.  
18 But to answer your question, I haven't done a lot of  
19 work with Quebec or Saskatchewan in terms of what they  
20 use for their long-term claimants.

21 MR. BYRON WILLIAMS: And just in --  
22 thank -- again, thank you for that answer. In -- in  
23 terms of -- and recognizing that you haven't done a lot  
24 of work in this area, are you aware whether or not, in  
25 terms of its accident benefit -- although the -- the

1 categories are slightly different in Saskatchewan,  
2 clearly, but in terms of their personal care costs and  
3 that, whether or not Saskatchewan relies upon  
4 experience from the Workers' Compensation system, sir?

5 MR. LUKE JOHNSTON: No, I'm -- I'm not  
6 aware of -- of what they do in that regard.

7 MR. BYRON WILLIAMS: Have you made any  
8 inquiries?

9 MR. LUKE JOHNSTON: None, other than  
10 discussions I spoke of, of possibly looking at the --  
11 the mortality patterns of our -- our two (2) claimant  
12 pools.

13 MR. BYRON WILLIAMS: And I think I know  
14 the answer to this one already, but just to -- to cross  
15 my -- my 'T', in terms of their weekly indemnity, are  
16 you aware whether or not they rely upon informa --  
17 information from Quebec?

18 MR. LUKE JOHNSTON: No, I'm not aware  
19 of this.

20

21 (BRIEF PAUSE)

22

23 MR. BYRON WILLIAMS: Mr. Johnston, in  
24 areas where these long tail -- tail claims where there  
25 is still such material uncertainty, do you have any

1 opinions on the value of seeking data from -- from  
2 other sources, whether it is another public auto  
3 insurer or a workers' compensation system?

4 Do you have any opinions on that, sir?

5

6 (BRIEF PAUSE)

7

8 MR. LUKE JOHNSTON: As -- as I  
9 mentioned before, we believe the mortality table that  
10 we're using is doing a good job. And we'll likely also  
11 see, in some of the evidence, that the -- the new  
12 reserving guidelines we're using produce a fairly  
13 consistent pattern that we're -- we're happy with.

14 I -- however, to -- to answer your  
15 question, I suspect that getting more data in -- in  
16 this regard could -- could add value. I don't know --  
17 I don't know to what extent and if it would really  
18 result in any change at all to the way we're -- we're  
19 forecasting our long-term claims right now.

20 MR. BYRON WILLIAMS: Mr. Johnston, when  
21 my -- when my client looks to a line of business like  
22 accident benefit other, you'll agree with me that they  
23 see a -- a -- still a pretty substantial tail factor?

24 MR. LUKE JOHNSTON: Other -- actually,  
25 I should probably explain a -- a tail factor. The --

1 the tail factor basically is, we -- we talked about the  
2 -- these claimants over ten (10) year -- that have been  
3 open for more than ten (10) years as being our lifetime  
4 claimants.

5                   And not having any experience for these  
6 claimants beyond about eighteen (18) years, we, of  
7 course, have to be very careful with how we forecast  
8 these claimants. If -- if you look at personal care,  
9 for example, there -- there still is significant risk  
10 there that claim payments could increase as claimants  
11 age.

12                   So we have a tail factor, but to  
13 describe it as significant or -- I don't know your  
14 exact words -- I don't -- I don't believe that to be  
15 true. Is it very difficult to estimate? Absolutely.  
16 Is it the best estimate that I have right now? Again,  
17 I -- it wouldn't be in there if I didn't believe it to  
18 be the case. But highly uncertain, I would agree with  
19 that.

20                   MR. BYRON WILLIAMS: I might have used  
21 the words "pretty big", Mr. Johnston. But I didn't  
22 think you were going to go -- go along with that.  
23 Let's go back to -- to CAC-1-56, the attachment. And  
24 we were focussing on the percentage pre -- prediction  
25 error column and the -- the consistent pattern of -- of



1 negative from 2004/'05 on, Mr. Johnston.

2                   You -- you recall that, before I  
3 sidetrack the conversation?

4                   MR. LUKE JOHNSTON: I do recall that.

5                   MR. BYRON WILLIAMS: And in your  
6 earlier statement you would say that normally with  
7 estimates you would expect to be sometimes above,  
8 sometimes below.

9                   But here at least, and again recognizing  
10 the introduction of the reserving calculator, we've got  
11 -- we -- we've had a fairly consistent pattern of  
12 negative, since '04/'05, correct?

13                   MR. LUKE JOHNSTON: That's correct.

14                   MR. BYRON WILLIAMS: And although we --  
15 we hope the worst is past, that suggests, to date, that  
16 there has been, over the last few years, a systematic  
17 over-prediction of actual claims.

18                   Fair enough?

19                   MR. LUKE JOHNSTON: Yeah, I -- I have -  
20 - I have to be careful with that, because the -- my  
21 predecessors and the previous appointed actuary did not  
22 have the data that I have today. So those were the --  
23 they used the information that -- that they had at --  
24 at the time to make their assumptions.

25                   Clearly, looking at where we're sitting

1 today and the magnitude of the reductions we've made to  
2 the liabilities over the last, you know, three (3) to  
3 four (4) years, you can say that, yes, we've -- we  
4 overstated those claims initially. And we now have  
5 better data and -- to make better assumptions and a --  
6 and a improved forecast.

7 MR. BYRON WILLIAMS: Now, Mr. -- now,  
8 Mr. Johnston, in that time period between '04/'05 and  
9 2010/'11, at any time did MPI receive a report from its  
10 external auditors suggesting that it would be  
11 unreasonable to rely on the final overall estimate of  
12 claims liabilities produced by the external actuary?

13 MS. MARILYN MCLAREN: No, we did not.

14 MR. BYRON WILLIAMS: Thank you.  
15 Directing again in CAC Exhibit 5, the excerpts from the  
16 record, just to page -- pages 2 through 6, Mr.  
17 Johnston. I'm going to suggest to you that this is a  
18 excerpt from last year's transcript of a discussion I  
19 had with the former external actuary, Mr. -- Mr.  
20 Christie.

21 And certainly, Mr. Johnston, I didn't  
22 show it to you till shortly before the hearing, so I'll  
23 try and take you to the right sentences. But if you  
24 feel at any time that I'm making you jump around or not  
25 giving you time to read the para -- the sentences, just

1 stop me and take the time you need.

2 But, Mr. Johnston, the purpose is -- I  
3 just want to clarify the role that the external auditor  
4 plays in assessing the reasonableness of the final  
5 overall estimate of claims liability produced by the  
6 external actuary. And you and I are both aware that  
7 Mr. Christie was the external actuary but I'll suggest  
8 to you that in this conversation he was really talking  
9 about the role of the auditor.

10 And -- and if you need a couple minutes  
11 to -- to assure yourself of that, please take that  
12 opportunity.

13 MR. LUKE JOHNSTON: And this is in  
14 regards to page 2 and 3 of -- of the transcripts that I  
15 have here?

16 MR. BYRON WILLIAMS: Yes, and -- and if  
17 you're looking for some -- if you're looking for some  
18 references, Mr. Johnston, just on page 1,180 near the  
19 bottom, line 22, you can see he's speaking about the --  
20 the audit -- the audit role. And likewise at the top  
21 of page 6, again you'll see speaking of the -- of  
22 the...

23

24

(BRIEF PAUSE)

25

1 MR. BYRON WILLIAMS: And, Mr. Johnston,  
2 if this is making you feel uncomfortable in this way, I  
3 can actually ask the questions a different way, and  
4 maybe that would -- and maybe I'll try it a different  
5 way if -- if that -- if that works better. Go ahead.

6 MR. LUKE JOHNSTON: Yeah, I apologize,  
7 I just want to, of course, feel comfortable reading  
8 through the material and understanding it before I give  
9 an answer.

10 MR. BYRON WILLIAMS: Well, let me try  
11 it a different way and then we may come back to it or -  
12 - or we may not.

13 Maybe we'll try it -- the -- the  
14 simplest way, Mr. Johnston, is for you to describe in  
15 terms of the review of claims liabilities what -- what  
16 you understand to be the role of the external auditor  
17 and -- and the consulting actuary. And really are they  
18 comment -- the question I'm putting to you, Are they  
19 commenting on the reasonableness of the overall  
20 estimate? Is -- is that what they're opinion is  
21 ultimately grounded in? That's the type of in --  
22 insight I'm seeking from you, sir.

23

24

(BRIEF PAUSE)

25

1 MR. LUKE JOHNSTON: Sorry, can you --  
2 can you repeat the question, please?

3 MR. BYRON WILLIAMS: I can't, because  
4 it was a poor question, but we'll try -- we'll try  
5 again. Within -- you -- you spoke the first day of the  
6 Hearing and again this morning of the role of the  
7 auditor in terms of a check and balance.

8 In terms of the actuarial liabilities  
9 and the report of the external actuary, what is the  
10 role of the auditor? Is it to comment on the overall  
11 reasonableness, is it to dissect line-by-line?

12 What does that auditor's signature mean,  
13 sir?

14

15 (BRIEF PAUSE)

16

17 MS. KATHY KALINOWSKY: I'm sorry, we're  
18 having a little bit of difficulty in -- in responding  
19 to this question. Over the past, I believe it's two  
20 (2) years, both KPMG -- KPMG attended and they provided  
21 evidence, particularly Mr. Neil Parkinson (phonetic)  
22 provided evidence as to what the role of the auditor is  
23 in that state -- in preparing the financial statements.  
24 And in -- particularly the role of the ex -- the -- the  
25 auditor's actuary in auditing Guideline 43, I think the

1 number is.

2 That's been put on the record two (2)  
3 years now. And if Mr. Williams would like me to  
4 produce those documents I certainly could again for the  
5 -- the Board.

6 MR. BYRON WILLIAMS: Recognizing we  
7 have a new panel, or a -- a newer panel, I would ask  
8 Manitoba Hydro to undertake to just provide a -- a  
9 summary of -- of those documents. I'm not looking for  
10 anything particularly extensive. I --

11 MS. KATHY KALINOWSKY: Sure, we can  
12 provide something then which will outline Mr.  
13 Parkinson's evidence on that.

14 MR. BYRON WILLIAMS: And for the court  
15 reporter, the -- the undertaking then is to outline Mr.  
16 Parkinson's evidence in terms of his role and the role  
17 of the consulting actuary.

18

19 --- UNDERTAKING NO. 15: MPI to outline Mr.  
20 Parkinson's evidence in  
21 terms of his role and the  
22 role of the consulting  
23 actuary

24

25 MS. KATHY KALINOWSKY: Yes.

1 (BRIEF PAUSE)

2

3 CONTINUED BY MR. BYRON WILLIAMS:

4 MR. BYRON WILLIAMS: Mr. Johnston,  
5 let's -- let's hope I don't stretch anyone's memory too  
6 much here, although Ms. Kalinowsky clearly has a better  
7 one than I do.

8 Would it be accurate to say that to your  
9 knowledge there is at least one (1) occasion where the  
10 external auditor for MPI found that the overall  
11 estimate of claims liabilities of the external actuary  
12 to be reasonable, even while finding certain specific  
13 estimates for particular lines of business to be beyond  
14 the range of reasonableness?

15

16 (BRIEF PAUSE)

17

18 MR. BYRON WILLIAMS: And if you're --  
19 if -- if MPI is looking for a -- a reference, I'm  
20 referring to the consulting actuary's April 2010  
21 report.

22 MS. MARILYN MCLAREN: Which the  
23 consulting actuary provided to KPMG, which the  
24 Corporation learned about when KPMG agreed to make it  
25 public for the proceedings two (2) years ago. So I --

1 I believe that that's a reasonable characterization of  
2 what that KPMG internal letter, which became public  
3 though these processes, said.

4 MR. BYRON WILLIAMS: Okay. So thank  
5 you. That's a yes. I appreciate that. Your head  
6 nodding, I guess, means a "yes," Ms. McLaren?

7 MS. MARILYN MCLAREN: Well, I think I  
8 used the words "I believe that's a reasonable  
9 characterization," so that's --

10 MR. BYRON WILLIAMS: Fair enough.

11 MS. MARILYN MCLAREN: -- pretty clear.

12 MR. BYRON WILLIAMS: Mr. Johnston, it  
13 probably goes to you and if it should go to Ms.  
14 Reichert, you'll just steer me the other way. I -- I  
15 want to chat with you about the Corporation's forecast  
16 for inflation and for interest rates in just a moment.

17 But before I do, I wonder if you can  
18 indicate whether you or any of your actuarial  
19 colleagues are aware of or have had the opportunity to  
20 review the PowerPoint presentation to the Canadian  
21 Institute of Actuaries dated September 27th, 2012,  
22 titled -- by Jonas Fisher of the -- F-I-S-H-E-R of the  
23 Federal Reserve Bank of Chicago on the topic of  
24 whither, W-H-I-T-H-E-R, US growth.

25 Are you aware of that document or have



1 you -- have you had occasion to see it, sir?

2

3 MR. LUKE JOHNSTON: I have not seen  
4 that document yet.

5 MR. BYRON WILLIAMS: So for the time  
6 being we'll restrict ourselves to whither Manitoba CPI  
7 or whither Canadian interest rates.

8 Mr. Johnston, you probably know this off  
9 by heart, but if you're looking for a reference in CAC  
10 Exhibit 5, it's page 7 in the top -- top right-hand  
11 corner.

12 MR. LUKE JOHNSTON: I'm there. Thanks.

13 MR. BYRON WILLIAMS: And again, I don't  
14 want to -- to walk too far down the path my Learned  
15 Friend, Ms. Grammond, walked upon last week.

16 But in terms of forecasting CPI or  
17 interest rates, my understanding of your evidence last  
18 week, Mr. Johnston, is that neither you or the  
19 Corporation profess to have any particular expertise as  
20 compared to the major banks or professional forecasting  
21 agencies in forecasting inflation rates, for example?

22 MR. LUKE JOHNSTON: Perhaps my words  
23 were not the greatest description. But I -- I think we  
24 -- we definitely have forecasting expertise in --  
25 internally. But to believe that -- that we have better

1 information or -- or can do a better job of forecasting  
2 inflation than the banks and pro -- professional  
3 forecasting agencies would probably be a stretch.

4 MR. BYRON WILLIAMS: So, essentially,  
5 for the purposes of forecasting interest rates, you  
6 rely on the major banks or -- or professional  
7 forecasting agencies?

8 MR. LUKE JOHNSTON: That's correct.

9 MR. BYRON WILLIAMS: And you...

10 And I'll get to Ms. McLaren's question.

11 And that goes for inflation, too, Mr. Johnston?

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

14 MR. BYRON WILLIAMS: And generally,  
15 without trying to get into too many details, you select  
16 a median forecast from these banks and forecasting  
17 agencies, correct?

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

20 MR. BYRON WILLIAMS: Now, if we look at  
21 inflation as measured by year-over-year change in the  
22 consumer price index, last year was a -- to -- being  
23 2011, was a bit of a tough year in Manitoba, with  
24 inflation at -- in the range of 3 percent.

25 Is that correct, sir?

1 MR. LUKE JOHNSTON: Yes, that's  
2 correct, as per the page 7 in your re -- in your  
3 reference material.

4 MR. BYRON WILLIAMS: And that, of  
5 course, was driven by high energy prices, coupled with  
6 high food prices, correct?

7 MR. LUKE JOHNSTON: I believe that's a  
8 reasonable explanation as, again, per that paragraph.

9 MR. BYRON WILLIAMS: And going out in  
10 time, the Corporation, for -- for the entire forecast  
11 period presented in this Rate Application, the  
12 Corporation is -- is forecasting more moderate CPI at 2  
13 percent per annum.

14 Is that right, sir?

15 MR. LUKE JOHNSTON: Moderate relative  
16 to the -- to the last year, but basically completely in  
17 line with the last twenty (20) years before that --  
18 pardon me -- on average.

19 MR. BYRON WILLIAMS: Thank you for  
20 that, Mr. Johnston. As compared to 2011, your  
21 inflation forecast is about 33 percent lower for the  
22 foreseeable future, correct, compared to the actuals  
23 for 20 -- 2011, sir?

24 MR. LUKE JOHNSTON: Yes. So two (2)  
25 relative to three (3) is about 33 percent lower, yeah.

1 MR. BYRON WILLIAMS: You didn't trust  
2 my math, did you, Mr. Johnston? I'm just teasing. Go  
3 ahead.

4

5 (BRIEF PAUSE)

6

7 MR. BYRON WILLIAMS: Just again, if  
8 you're trying to follow along in the excerpts from the  
9 record, just looking at pages 8 through 11 from the CAC  
10 book of documents, Exhibit number 5, we've discussed  
11 the methodology.

12 And -- and really starting at page 9, if  
13 I were to -- to -- you'll agree with me, Mr. Johnston,  
14 that presented in the -- the middle of this page are  
15 the interest rate forecasts for the government of  
16 Canada, ten (10) year bonds?

17 Do you see that, sir?

18 MR. LUKE JOHNSTON: Yes, I do.

19 MR. BYRON WILLIAMS: And recognizing  
20 that the Corporation tends to rely upon the median --  
21 M-E-D-I-A-N -- if I were to looking at the  
22 Corporation's interest rate forecast for the Government  
23 of Canada ten (10) year bonds, I would see the  
24 Corporation expects an increase in interest rates going  
25 forward.

1                   Would that be fair?

2                   MR. LUKE JOHNSTON:   That is what we're  
3 forecasting.  But again, it's -- it is the expectation  
4 of the banks listed in -- in the table.

5                   MR. BYRON WILLIAMS:   And you rely upon  
6 that -- those -- those expectations for the purposes of  
7 your forecast?

8                   MR. LUKE JOHNSTON:   Yes, we do.

9                   MR. BYRON WILLIAMS:   And, likewise, we  
10 see a -- when we focus on Treasury bills at the bottom  
11 of that page again, we see a expectation presented in  
12 the Corporation's forecast of an increase in interest  
13 rates going forward, correct?

14                  MR. LUKE JOHNSTON:   Correct.

15                  MR. BYRON WILLIAMS:   And, not needing  
16 to go into the details, but when we look farther out in  
17 time, again, we see the Corporation forecasting, over  
18 time, a fairly robust growth in interest rates,  
19 correct?

20                  MR. LUKE JOHNSTON:   Yes, I -- I won't  
21 pretend to have knowledge of the -- how they set their  
22 forecasts at the banks, but the tendency is that as the  
23 -- we go longer into the future, it reverts closer to  
24 the historical long -- longer-term average.

25                  MR. BYRON WILLIAMS:   This may go to Ms.

1 -- excuse me -- Ms. Reichert or to Mr. -- Mr. Johnston.  
2 And I do want to understand, again without trespassing  
3 too much where my friend Ms. Grammond went, the impact  
4 of higher interest rates on both the income and costs  
5 of MPI. But before I get there, I -- I'd like to use a  
6 simplified example to assist both my client and -- and  
7 myself in understanding.

8                   So I -- I'd like you to turn to CAC  
9 Exhibit number 6. And, Ms. Reichert, before we go into  
10 the -- the nitty gritty of this simplifized (sic)  
11 illustration, I wonder if we can agree on a definition  
12 of "discount rate"?

13                   If I suggested to you that for the  
14 purposes of this discussion, a discount rate represents  
15 the interest rate used in discounted cash flows  
16 analysis to determine the present value of future cash  
17 flows, is that something you could agree with?

18                   MR. LUKE JOHNSTON: I can agree with  
19 that.

20                   MR. BYRON WILLIAMS: Essentially, the  
21 discount rate takes into account the time value of  
22 money?

23                   Would that be fair?

24                   MR. LUKE JOHNSTON: That's fair.

25                   MR. BYRON WILLIAMS: And when we think

1 of the time value of money, we mean the idea that money  
2 available now is worth more than the same amount of  
3 money in the future?

4 Would that be fair?

5 MR. LUKE JOHNSTON: That's fair.

6 MR. BYRON WILLIAMS: And it means more  
7 for, I'm going to suggest to you, Mr. Johnston, for a  
8 couple of reasons: A) it could be earning interest; and  
9 B) there's always risk or uncertainty associated with  
10 anticipated future cash flows.

11 Fair enough?

12 MR. LUKE JOHNSTON: That's fair.

13 MR. BYRON WILLIAMS: Now, we're going  
14 to be moving to the absolute limits of my mathematical  
15 ability. Let's say one expects a thousand dollars in  
16 one (1) year's time, Mr. Johnston.

17 Could you assume that for me, just for  
18 the purpose of -- of an example?

19 MR. LUKE JOHNSTON: Expects one  
20 thousand dollars (\$1,000) in a year's time?

21 MR. BYRON WILLIAMS: Yes. To determine  
22 the present value of that one thousand dollars  
23 (\$1,000), what it's worth today, you'd need to discount  
24 it by a particular rate of interest.

25 Would that be fair?

1 MR. LUKE JOHNSTON: That's fair.

2 MR. BYRON WILLIAMS: And, for the  
3 panel, we're not yet at the -- at the table, obviously.  
4 I'm just trying to make sure Ms. Desorcy and I are on  
5 the same page as Mr. Johnston.

6 So assuming a discount rate of 10  
7 percent, the one thousand dollars (\$1,000) in a year's  
8 time would be the equivalent of nine dollars (\$9.00) --  
9 nine (9) -- nine hundred and nine dollars (\$909),  
10 excuse me, and nine (9) cents today.

11 Would you agree with that, sir?

12 MR. LUKE JOHNSTON: I'd agree with  
13 that. So, yeah, if -- if you -- if you put nine  
14 hundred dollars and nine cents (\$900.09) in your bank  
15 account right now, and are fortunate enough to get 10  
16 percent interest, that'd be a thousand dollars (\$1,000)  
17 by the end of the year.

18 MR. BYRON WILLIAMS: Well, I said it  
19 was Mr. -- simplified, Mr. Johnston. Why don't we talk  
20 about 2 and 3 percent interest rates instead. And  
21 let's look at this simple illustration. And, Mr.  
22 Johnston -- we probably -- we should have done it in  
23 larger font for Ms. Desorcy, but hopefully she can read  
24 it. I'm having to raise my glasses here.

25 I'm going to ask you to make two (2)



1 assumptions. One is at -- at the top we're going to  
2 assume that we're purchasing a bond that's under --  
3 beside the number 1 on January 1st, 2012, for 100  
4 million at par with the coupon rate of 2 percent paying  
5 semi annual interest payments, and that this bond will  
6 mature in three (3) years.

7 Do you see that, Mr. Johnston?

8 MR. LUKE JOHNSTON: Yes, I do.

9 MR. BYRON WILLIAMS: Okay. And again  
10 we're not suggesting this is the reality of Manitoba  
11 Public Insurance, we're just doing this for  
12 illustrative purposes.

13 So if we see under the -- this bond  
14 trading at par, would -- I'll suggest to you that --  
15 Mr. Johnston, that -- that this is the status quo with  
16 a value of 100 million, a coupon rate of -- of 2  
17 percent, a time to maturity of three (3) years, and a  
18 current yie -- yield of 2 percent with the price  
19 allowing for some vicissitudes in supply and demand of  
20 \$100 million.

21 Do you see that, sir?

22 MR. LUKE JOHNSTON: I do. So the --  
23 the price is again the same because in this case the --  
24 the amount of interest you're receiving is equivalent  
25 to the -- the yield rate of two (2) and 2 percent.

1 MR. BYRON WILLIAMS: And just before we  
2 leave the status quo for the bond, I'd ask you to  
3 direct your attention to the -- the right side of the  
4 table, and you'll see a headline, "Payment Pattern."

5 Do you see that, Mr. Johnston?

6 MR. LUKE JOHNSTON: Yes, I do.

7 MR. BYRON WILLIAMS: And this is  
8 essentially how the semi-annual interest payments are  
9 being paid out. That's what this is intended to -- to  
10 represent.

11 Is that correct, sir?

12 MR. LUKE JOHNSTON: That's right. The  
13 -- the semi-annual payments, and then one (1) large  
14 payment of a coupon and principle at the -- on the last  
15 day.

16 MR. BYRON WILLIAMS: Thank you for  
17 that. Going now to kind of the num -- or to the number  
18 2, again we're asking the reader to assume an unpaid  
19 claim reserve of \$100 million -- of \$100 million was  
20 incurred on January 1st, 2012, and will be paid in  
21 three (3) years, and that the unpaid claims liability  
22 will be discounted based on the bond rates.

23 Do you see that, Mr. Johnston?

24 MR. LUKE JOHNSTON: Yes, I do.

25 MR. BYRON WILLIAMS: And going to the

1 discounted at 2 percent column. Again you see the  
2 undiscounted value of \$100 million, you see the  
3 interest rate of 2 percent, the years to payment of  
4 three (3), and the discounted value calculated, for  
5 illustrative purposes, to be just a bit over \$94  
6 million.

7 Do you -- do you see that, Mr. Johnston?

8 MR. LUKE JOHNSTON: Yes, I do, and  
9 similar to your above calculation where we talked -- or  
10 pardon me, not your above calculation, but the  
11 calculation where we talked about the thousand dollars  
12 (\$1,000). In this case, \$94 million today growing at 2  
13 percent a year will equal the approximately \$100  
14 million by the third year.

15 MR. BYRON WILLIAMS: Thank you for  
16 anticipating my question. I appreciate that. So when  
17 we move to the trading -- or to the trade net discount,  
18 or the discounted at 3 percent column, let's go up --  
19 back up to the bonds.

20 And again we're asking the reader to  
21 assume that there's been a 1 percent increase --  
22 increase in interest rates on the market value of a  
23 bond, and a discounting effect on unpaid claims  
24 reserves.

25 So, Mr. Johnston, looking at the trading

1 in discount, if we compare the -- that column to the  
2 trading at par we see two (2) different -- two (2)  
3 differences. One is the current yield which is 1  
4 percent higher, and one is the price which is lower,  
5 suggesting the bond is -- is less valuable.

6 Do you see that, sir?

7 MR. LUKE JOHNSTON: Yes, I do, and now  
8 we're in a situation where the required yield is higher  
9 than the coupon payment interest rate. So in order to  
10 achieve that 3 percent yield, the bond needs to be  
11 priced a lower amount. Calculations are a bit more  
12 complicated now with all the cash flows, but that's the  
13 idea.

14 MR. BYRON WILLIAMS: And if we go down  
15 to the unpaid claim discounted at 3 percent, we again  
16 see that the interest rate is different and that the  
17 discounted value is somewhat lower than it was before.

18 Do you see that, Mr. Johnston?

19 MR. LUKE JOHNSTON: That's right. Now,  
20 you -- you don't need as -- as much money put aside  
21 today now that you're expecting a higher interest rate.

22 MR. BYRON WILLIAMS: So there's good  
23 news on the claims liability side from the 1 percent  
24 increase in interest rates and not as good news on the  
25 -- the bond side.

1                   Would that be fair, sir? Flowing from  
2 the 1 percent increase.

3                   MR. LUKE JOHNSTON: That's fair.

4                   MR. BYRON WILLIAMS: And it doesn't  
5 come out perfectly in the -- the wash in that in this  
6 simplified illustration, the -- there -- there's a  
7 sixty-eight thousand dollar (\$68,000) decrease in net  
8 income.

9                   Is that right, sir?

10                  MR. LUKE JOHNSTON: Yes, and we -- we  
11 talked -- actually, I'll just say yes for now. I'll  
12 let you ask a question.

13                  MR. BYRON WILLIAMS: You were doing  
14 better than my -- my questions, Mr. Johnston, and I'm  
15 not trying to burden you much farther. But -- so  
16 there's a rough matching, but there's not certitude in  
17 -- in terms of the bottom line.

18                  The -- the impacts are -- are still  
19 somewhat uneven?

20                  MR. LUKE JOHNSTON: That's correct.  
21 And all -- all I was going to say is this is  
22 essentially the -- a similar idea as we talked about,  
23 asset liability matching. And in the -- in our reality  
24 it won't be even as clean as this or as accurately  
25 matched as this. But again, we hope to get that fairly

1 close.

2 MR. BYRON WILLIAMS: Mr. Chairman, I  
3 can continue or we can take our -- our break. I have a  
4 -- I do have some questions I need to ask of my client,  
5 so if there's an appropriate time.

6 THE CHAIRPERSON: Is fifteen (15)  
7 minutes enough? Let's take fifteen (15) minutes, so  
8 back in this room at, say, five (5) to -- five (5) to  
9 11:00.

10

11 --- Upon recessing at 10:38 a.m.

12 --- Upon resuming at 10:55 a.m.

13

14 CONTINUED BY MR. BYRON WILLIAMS:

15 MR. BYRON WILLIAMS: Mr. Johnston,  
16 we're -- Mr. Johnston -- oh, sorry.

17 MS. KATHY KALINOWSKY: If Mr. -- prior  
18 to the cross-examination, Mr. Johnston just wants to  
19 make a comment with respect to one of the responses  
20 that he gave just prior to the break, if that's all  
21 right with you, Mr. Williams.

22 MR. BYRON WILLIAMS: Absolutely.

23 MR. LUKE JOHNSTON: Thank you. I  
24 didn't -- on -- on CAC Exhibit 6, I -- I didn't notice  
25 the -- the wording used, but it says it characterizes

1 the difference in the -- in the asset and liability  
2 matching here as immunization ineffectiveness.

3 I don't know if that wording is  
4 intentional, but the -- this cash flow pattern shown  
5 here is fairly simplified. We could match this 100  
6 percent and be 100 percent immunized if we purchase the  
7 right type of bond.

8 But I -- I don't want to understate -- I  
9 don't want in any way for this to understate the  
10 importance of our asset and liability matching program.  
11 We have evidence that -- that shows that our program  
12 matches about 80 to 90 percent of -- of these changes.

13 And if you think about changing these  
14 numbers here to amounts in billions, and you think  
15 about the impact of interest rates increasing and  
16 massive changes in asset values you can -- you can see  
17 the importance of having the -- the offset on the  
18 liabilities side to match that even if it's not  
19 perfect.

20 Eighty (80) to 90 percent is, you know,  
21 clearly better than some -- some number much lower than  
22 that or not matched at all. So I just wanted to make  
23 sure that was clear. And I didn't want our -- our  
24 asset liability program in any way to be seen as  
25 ineffective.

1

2 CONTINUED BY MR. BYRON WILLIAMS:

3

MR. BYRON WILLIAMS: And, Mr. Johns --  
4 Mr. Johnston, I think those words escaped my attention  
5 too, so I don't think there was a plan. The -- I do  
6 want to talk about your asset and liability management  
7 program. Before I get there I do want to make sure I  
8 understand your definition of "actuarial present  
9 value".

10

As I understand it, actuarial present  
11 value is:

12

"A sum of future payments discounted  
13 at an interest rate determined from  
14 the balance sheet yield of the  
15 Corporation's portfolio with  
16 provisions for adverse deviation, for  
17 example, claims development,  
18 uncollectible reinsurance, and  
19 investment return rate."

20

Would that be fair, sir?

21

MR. LUKE JOHNSTON: That's fair.

22

MR. BYRON WILLIAMS: And flowing from  
23 that definition and in terms of how assumptions  
24 relating to interest rate levels might affect -- affect  
25 claims liabilities, would I be correct in suggesting



1 that one way would be in the assumed discount rate?

2 MR. LUKE JOHNSTON: Can you rephrase  
3 that, please, sorry, or simply repeat it?

4 MR. BYRON WILLIAMS: If we're trying to  
5 understand how assumptions relating to interest rates  
6 might affect claims liabilities, and going back to that  
7 definition of actuarial present value, one (1) way in -  
8 - in which that might occur is in -- in terms of the  
9 assumpt -- the dis -- the interest rate in -- at which  
10 it is dis -- discounted.

11 Fair enough?

12 MR. LUKE JOHNSTON: Yes, sorry. Yeah,  
13 a very -- a very key factor is the discount rate  
14 assumed in that calculation.

15 MR. BYRON WILLIAMS: Yes. And, Mr.  
16 Johnston, you don't have to apologize for my poor  
17 questions. The -- another factor in -- in which  
18 investment -- expectations in terms of investment  
19 return rate might affect the assumption in terms of --  
20 or the estimate in terms of claims liability would be  
21 in terms of the provision for adverse deviation of the  
22 investment return rate, correct?

23 MR. LUKE JOHNSTON: That's correct.

24

25 (BRIEF PAUSE)

1 MR. BYRON WILLIAMS: And, Mr. Johnston,  
2 you were so -- so keen to talk about your asset  
3 management plan. If the Board is following around in -  
4 - along in CAC Exhibit number 5, there's an excellent  
5 information request at page 11, or the response is  
6 excellent even if the request was not so much. That's  
7 CAC-2-74 in the top right-hand corner.

8 But, Mr. Johnston, the point you made  
9 right after the break was that as -- as interest rates  
10 change in future years, to a significant extent the --  
11 the Corporation's assets and liabilities will -- and  
12 their management program will result in offsetting  
13 changes to assets and liabilities. That's the intent  
14 of the program?

15 MR. LUKE JOHNSTON: Yeah, significantly  
16 off -- offset impacts. I -- I spoke last week, I  
17 believe, that the Department of Finance has some leeway  
18 in how they match assets to the liabilities, that being  
19 to keep the asset duration within plus or minus two (2)  
20 years.

21 MR. BYRON WILLIAMS: And, essentially,  
22 the goal of this program is to reduce volatility in --  
23 in the changes -- in the relative changes of the value  
24 of assets and liabilities. Would that be fair -- due  
25 to interest rate cho -- changes?

1                   Let me try that again. Essentially, the  
2 goal of this program is to reduce the volatility due to  
3 interest rate changes in the relative value of assets  
4 and liabilities. Would that be fair?

5                   MR. LUKE JOHNSTON: That's fair.

6                   MR. BYRON WILLIAMS: And if we look at  
7 this specific example, we're starting with the premise  
8 at the top, in the preamble, of unpaid claims in the  
9 range of \$1.49 billion and a fixed income portfolio  
10 valued at \$1.5 billion. And what this response  
11 outlines is that a hundred basis point decrease in the  
12 market yield results in a increase in the present value  
13 of the bou -- bond portfolio by about \$78 million, and  
14 an increase in the present value of the liabilities by  
15 some 58 million, correct?

16                  MR. LUKE JOHNSTON: That's correct.

17                  MR. BYRON WILLIAMS: In this case, the  
18 Corporation's a bit better off with the hundred basis  
19 point decrease, in that the value of the bond  
20 portfolio's increase outweighed the increase in the  
21 present value of the liabilities, correct?

22                  MR. LUKE JOHNSTON: That's true. I  
23 won't -- I'm not sure if the -- why a hundred basis  
24 point decrease was used. That's maybe not that  
25 realistic, but if -- if that particular impact

1 happened, that would -- that would be the expected  
2 impact on -- on both assets and liabilities, yes.

3 MR. BYRON WILLIAMS: In this particular  
4 example, there certainly is a -- a mitigation of the  
5 impact, but there's -- given, perhaps, the size of the  
6 basis point change there still is a fairly material  
7 impact in terms of volatility, though, some 20 million?

8 MR. LUKE JOHNSTON: Yes, that's fair.  
9 Twenty (20) million dollars, of -- of course, would be  
10 considered material to -- to me. Again, we -- we don't  
11 expect to be fully immunized, but significantly.

12 MR. BYRON WILLIAMS: And just going the  
13 other way, Mr. Johnston, if we could -- and I don't  
14 need a -- a calculation from you, but directionally a  
15 hundred point basis -- a hundred basis point increase  
16 in the yield on the Corporation's marketable bond  
17 portfolio, would result in a decrease in the present  
18 value of the bond portfolio and a decrease in the  
19 present value of the liabilities.

20 Is that correct?

21 MR. LUKE JOHNSTON: Directionally, yes,  
22 that's correct.

23 MR. BYRON WILLIAMS: And just for the  
24 clarification of -- of my client, just because the  
25 decrease made a -- a twenty (20), or 19.7 million

1 difference one way, we wouldn't necessarily expect the  
2 same proportionate change the other way? Is that  
3 correct, Mr. Johnston?

4 MR. LUKE JOHNSTON: No, you wouldn't.  
5 The -- the larger the changes in interest rates, the  
6 more they -- they deviate. We are looking at a  
7 particular point in time, of -- of course. The  
8 Corporation wouldn't stand still as interest rates  
9 gradually rise. We would expect it to, you know,  
10 manage our -- our asset -- assets and liabilities  
11 appropriately. But the -- the changes aren't  
12 necessarily the same for a -- a plus fifty (50) or a  
13 hundred basis points, or -- or minus fifty (50) to a  
14 hundred basis points.

15

16 (BRIEF PAUSE)

17

18 MR. LUKE JOHNSTON: I -- I'm just  
19 looking for a reference where I think I actually answer  
20 that question. One second.

21

22 (BRIEF PAUSE)

23

24 MR. BYRON WILLIAMS: It's not CAC-1-73.  
25 Shall I wait, Mr. Johnston?

1 (BRIEF PAUSE)

2

3 MR. LUKE JOHNSTON: Yes, please.

4

5 (BRIEF PAUSE)

6

7 MR. BYRON WILLIAMS: It may well be...

8

9 (BRIEF PAUSE)

10

11 MR. LUKE JOHNSTON: In PUB-1-17 Part C,  
12 we were asked to basically show a plus or minus 0.5  
13 percent change in the discount rate for liabilities.  
14 And when interest rates decrease by half a percent, the  
15 liabilities went up by about \$50 million. And when the  
16 rate increased, the liabilities went down by about 75  
17 million.

18 So the changes are not uniform on each  
19 side but keeping in mind that it's also the -- the  
20 percentage change in the -- in the yield, like on an  
21 absolute basis, is not the -- the same either.  
22 Dropping from two (2) to one and a half (1 1/2), for  
23 example, is not necessarily the same percentage change  
24 as going from two (2) to two and a half (2 1/2).

25 MR. BYRON WILLIAMS: Thank you, Mr.

1 Johnston, and I'm sorry I misdirected you on the  
2 response. Just in terms of conceptually, the asset  
3 management strategy stands separate and apart from the  
4 actuarial calculation of the provision for adverse  
5 deviation. There's no mathematical relationship.

6 A change in one won't affect -- affect  
7 the other?

8

9 (BRIEF PAUSE)

10

11 MR. LUKE JOHNSTON: To -- I -- I  
12 believe you're asking, correct me if I'm wrong: Was  
13 the effectiveness of our actu -- asset and liability  
14 matching program a consideration in the selection of  
15 the interest rate PFAD? No, it was not.

16

17 (BRIEF PAUSE)

18

19 MR. BYRON WILLIAMS: Mr. Johnston --  
20 and I'm going to ask the -- your indulgence and the  
21 indulgence of the Board -- directing your attention to,  
22 in the top right-hand corner, page 15 of the CAC  
23 Exhibit 5, which is an excerpt of a transcript and,  
24 really, a very interesting conversation you had with  
25 Ms. Everard -- or, Ms. Grammond, excuse me, about the -

1 - the impact -- well, excuse me, in terms of the  
2 decision-making relating to the decision to increase  
3 the PFAD for the interest rate margin by twenty-five  
4 (25) basis points.

5                   Without asking you to remember the  
6 details as -- as of yet, Mr. Johnston, you remember the  
7 conversation?

8                   MR. LUKE JOHNSTON:    Yes, I do.

9                   MR. BYRON WILLIAMS:    And I want to --  
10 to walk you through some of the highlights of that  
11 conversation from my perspective.

12                   And just directing your attention to the  
13 -- again to page 15, in the top right-hand corner page  
14 45 of the transcript, we -- we see a -- a conversation  
15 in which you indicate that in terms of the pre -- PFAD  
16 provision, you didn't go to the new appointed actuary  
17 and ask for an increase in the provision for the  
18 interest rate margin.

19                   Is that correct, sir?

20                   MR. LUKE JOHNSTON:    That's correct.

21                   MR. BYRON WILLIAMS:    He presented a  
22 case to you which you considered fairly compelling.  
23 The change was made with a -- roughly a \$33 million  
24 impact.

25                   Would that be fair?



1 MR. LUKE JOHNSTON: Yes, that's fair.

2 MR. BYRON WILLIAMS: And just directing  
3 your attention, Mr. Johnston, to -- to page 16 at the  
4 bottom now of the transcript, lines 23, 24, and 25,  
5 then moving on to the next page, I'll suggest to you  
6 here that, notwithstanding the move to one hundred and  
7 twenty-five (125) basis points, you're suggesting in --  
8 in this passage a significant fondness for the one  
9 hundred (100) basis points perspective, in that you  
10 found that very reasonable.

11 Does that sound fair, sir?

12 MR. LUKE JOHNSTON: Yes, that's fair.

13

14 (BRIEF PAUSE)

15

16 MR. BYRON WILLIAMS: And, Mr. Johnston,  
17 why I found the conversation so intriguing is you --  
18 you just kept going on and going on. And I direct your  
19 attention to page 18 at the bottom, where you're  
20 suggesting that you're going to go back -- line 17 to  
21 25, that you're -- that -- that when you -- when the  
22 actuary goes back in the -- in October, he may decide  
23 that this \$33 million adjustment is no longer required  
24 and that you're going to expect your appoint -- the  
25 appointed actuary to provide evidence for why the

1 margin needs to remain at 1.25 percent.

2 Do you see that, sir?

3 MR. LUKE JOHNSTON: Yes, that's  
4 correct. I -- clearly, this is a -- a fairly  
5 significant change, in terms of dollars. So I just  
6 wanted the Board to understand the process of how we  
7 got to that assumption change, how it was brought  
8 forth, why I -- I believe that our -- our prior  
9 assumption was reasonable, and -- and why I was  
10 convinced by the evidence from our appointed actuary  
11 that the margin should -- should increase.

12 Again, and if -- if -- all I was stating  
13 in this section was that if -- it would be my  
14 expectation that if -- if our appointed actuary was to  
15 use the -- the evidence that they did to support  
16 increase in that margin, if that evidence no longer  
17 existed, I wouldn't -- it wouldn't be my expectation  
18 that that margin would remain at that level.

19 Again, that is the -- that's the  
20 judgment from our appointed actuary, but those are my  
21 comments.

22 MR. BYRON WILLIAMS: And, Mr. Johnston,  
23 you kind of finished off that same passage saying, line

24 25: "That's all I can really say."

25 Do you see that?

1 MR. LUKE JOHNSTON: I -- I don't  
2 remember the exact contents -- context, but I was in a  
3 discussion about -- that -- that again, this assumption  
4 is -- is somewhat reasonable and -- and, as I've just  
5 described, those are my expectations on how I would  
6 expect the process to go at the -- at the next -- at  
7 the next review. So that's all I can really say about  
8 -- about that issue.

9 MR. BYRON WILLIAMS: And then just  
10 directing your attention to the next page, Mr.  
11 Johnston, because it wasn't all you could really say.  
12 You had to say more. And you're back there defending  
13 that 1 percent and -- and offering the perspective that  
14 you think it's reasonable for such a long-tailed  
15 business as MPI.

16 Do you see that?

17 MR. LUKE JOHNSTON: Yes, I do.

18 MR. BYRON WILLIAMS: Mr. Johnston, you  
19 strike me as a very confident and eloquent person.

20 But would I be correct in suggesting to  
21 you that you're not very confident that the one hundred  
22 and twenty-five (125) basis point PFAD should be  
23 maintained?

24

25 (BRIEF PAUSE)

1 MR. LUKE JOHNSTON: I -- I think I've  
2 stated why I'm confident in -- in the -- the new  
3 selection. I don't, of course, want to say that I  
4 thought of it, because I didn't. And, yeah, as I've --  
5 as I've mentioned, I thought the -- our appointed  
6 actuary made a strong case to change it and -- and I wa  
7 -- I was okay with that approach.

8 All I'm saying is that, to be confident  
9 again, I'll expect that same level of -- of detail from  
10 our appointed actuary and the same -- same rationale.

11 MR. BYRON WILLIAMS: And you stated  
12 previously that you -- you'd expect that same level of  
13 detail or -- or evidence.

14 And, in essence, the -- the evidence  
15 that the external actuary relied upon was higher  
16 inflation and lower trending interest rates, correct?

17

18 (BRIEF PAUSE)

19

20 MR. LUKE JOHNSTON: Tha -- that's  
21 correct. I just wanted to have the reference. And  
22 that's the appointed actuaries report from October, AI-  
23 11. And in -- on page 48 we see the -- the real return  
24 at 3.3 percent in October. My apologies, I'll let you  
25 get to that spot.

1 MS. CANDACE GRAMMOND: I think it's  
2 actually AI-10. I think you said AI-11, Mr. Johnston.

3 MR. LUKE JOHNSTON: Thank you.

4 MS. CANDACE GRAMMOND: Mr. Pelly  
5 pointed that out, so I'm not taking credit for it  
6 either.

7

8 (BRIEF PAUSE)

9

10 MR. LUKE JOHNSTON: So that again is  
11 the -- the middle table in -- on page 48 of AI-10, the  
12 October review. So in this -- in this table, like,  
13 well, you see the -- the real return ranging from a  
14 high of about 4.02 percent in October, '09, to a low of  
15 0.67 percent in October, 2011.

16 My understanding of the appointed  
17 actuary's view is that both the variability in these  
18 numbers and the very significant low number as of  
19 October 2011, are the -- the main rationale for  
20 increase in the PFAD.

21

22 CONTINUED BY MR. BYRON WILLIAMS:

23 MR. BYRON WILLIAMS: And just to go  
24 back, and I belie -- in -- in terms of my question and  
25 -- and recognizing the nuance you put onto it, but the

1 -- the drivers of that, his concern were volatility  
2 coupled with high inflation and lower trending interest  
3 rates.

4 Fair enough?

5 MR. LUKE JOHNSTON: I think that's  
6 fair, yeah.

7 MR. BYRON WILLIAMS: And it would be  
8 accurate to say that when MPI surveys current forecasts  
9 of leading banks it can -- it can see that they are  
10 forecasting significantly lower inflation for Manitoba  
11 than last year?

12

13 (BRIEF PAUSE)

14

15 MR. LUKE JOHNSTON: I -- I haven't  
16 looked at the -- in detail at the latest inflation  
17 forecasts from the bank. We will, of course, get a --  
18 get an update on these numbers in October. But I  
19 haven't -- haven't reviewed an updated interest rate  
20 forecast as -- as you -- of -- you -- you would see in  
21 our evidence in -- in TI.18, for example.

22 MR. BYRON WILLIAMS: Even the -- the  
23 Corporation's forecast is significantly lower than the  
24 actuals for last year, sir?

25 MR. LUKE JOHNSTON: The Corporation's

1 forecast has been at or very close to 2 percent for a  
2 while now. The -- there has been very signif --  
3 significant variability in recent years, ranging from  
4 almost no inflation - zero point six (0.6) or four (4),  
5 I believe, up to 3 percent in -- in the latest year.

6                   Throughout that whole period, the  
7 forecasts that the Corporation has received from the  
8 banks generally indicated about 2 percent in -- in all  
9 cases. So the -- that's what we're forecasting, based  
10 on the information we have. But it -- it can still  
11 definitely be variable, as we've just seen over the  
12 last few years.

13                   MR. BYRON WILLIAMS:   And we may resume  
14 this conversation tomorrow, Mr. Johnston. Certainly,  
15 it's also fair to say that the banks are generally  
16 forecasting a modest growth in -- in interest rates,  
17 correct?

18                   MR. LUKE JOHNSTON:   Yes, I believe you  
19 have evidence there showing that, in particular. But a  
20 modest growth in interest rates in the short term,  
21 accelerating more in the -- in the longer term.

22                   MR. BYRON WILLIAMS:   Moving on, Mr.  
23 Johnston, and to -- for the panel, to page 20 in the  
24 top right-hand corner of CAC Exhibit number 5.

25                   Mr. Johnston, I don't know if I scrawled

1 over your copy like I -- I did in mine, but I am  
2 directing your attention -- this is an excerpt you'll  
3 see from your pre-filed evidence of June 15th, 2012,  
4 correct?

5 MR. LUKE JOHNSTON: That's correct.

6 MR. BYRON WILLIAMS: And in particular,  
7 I want to direct your attention to the -- the second  
8 paragraph and the discussion beginning, "As of February  
9 29th, 2012." And without meaning to read it all to  
10 you, you see the Corporation was concerned about a  
11 relatively low equity return forecast. And then I do  
12 want to read this sentence:

13 "The Corporation believes that such a  
14 forecast is inapp -- inappropriate,  
15 given the average annual return of  
16 the Toronto Stock Exchange  
17 brackets] (TSX) over any rolling  
18 twenty (20) year [in brackets] (i.e.,  
19 long term) period has never been  
20 below 5.2 percent."

21 Do you see that, Mr. Johnston?

22 MR. LUKE JOHNSTON: Yes, I do.

23 MR. BYRON WILLIAMS: You see the  
24 Corporation is proposing to add a minimum equity  
25 return. And then again drawing your attention to the



1 next sentence:

2 "The proposed minimum is based on the  
3 5th percentile of annual returns on  
4 the TX -- TSX, over all rolling  
5 twenty (20) year periods."

6 Do you see that, sir?

7 MR. LUKE JOHNSTON: Yes, I do.

8 MR. BYRON WILLIAMS: And the  
9 Corporation is making some -- some powerful statements,  
10 in terms of the -- the average annual return never  
11 being below 5.2 percent and -- and the proposed minimum  
12 being based on the 5th percentile of annual returns on  
13 the TSX, over all rolling twenty (20) year periods.

14 We're agreed on that?

15 MR. LUKE JOHNSTON: Yes, that -- that's  
16 what it says in that paragraph.

17 MR. BYRON WILLIAMS: In terms of the --  
18 the basis -- and if you need a reference, Mr. Johnston,  
19 it's the next page.

20 But in terms of the basis for those --  
21 those statements that it had never been below 5.2  
22 percent and it was over all rolling twenty (20) year  
23 periods, so focus -- am I correct in suggesting to you  
24 that those statements were based upon an analysis of  
25 the Standard and Poor's TSX composite to -- composite

1 total return index from 1956 to February 29th, 2012?

2 Is that right, sir?

3 MR. LUKE JOHNSTON: Yes, that's  
4 correct. And my understanding is that is the available  
5 range for that index in -- in the Bloomberg investment  
6 system that we use. I -- I don't pull the data, but  
7 perhaps I could get the details of that for you. I --  
8 I don't know the -- the details.

9 MR. BYRON WILLIAMS: I'm not sure it's  
10 particularly necessary. Mr. Johnston, I'm just  
11 wondering -- and perhaps you've already answered that.

12 The Corporation went back to 1956; why  
13 not go back to 1919?

14

15 (BRIEF PAUSE)

16

17 MR. LUKE JOHNSTON: I'd have to get  
18 back to you on the -- like to confirm that the -- that  
19 was indeed related to the Bloomberg system, but I -- I  
20 can do that.

21

22 (BRIEF PAUSE)

23

24 THE CHAIRPERSON: Do you mind if I ask  
25 a few questions here? And I think I understand where

1 Mr. Williams is coming from. I guess here the -- the  
2 statement -- or, pardon me, the document seems to  
3 suggest that, you know, we've never seen anything below  
4 5.2 percent. And the apparent dichotomy here is  
5 between what you're using for DCAT and what's being --  
6 what -- what's included in this statement. In other  
7 words, we never got below 5.2 percent and then on the  
8 DCAT we're saying we could go as low as 40 percent loss  
9 on the -- so there's a bit of a dichotomy there.

10 And -- and I guess the other dichotomy  
11 that I can see is that you're using return -- index  
12 returns for this statement but you're using portfolio  
13 managers who are not using index returns. They're --  
14 they're using their own results, I guess, which --  
15 which on the face of it appear to be lower than what  
16 the index has been generating over -- over the years.

17 So two (2) -- two (2) places where I see  
18 a bit of a dichotomy, and I just what to understand  
19 your thinking there.

20 MR. LUKE JOHNSTON: I'll talk first on  
21 the -- on your first question which relates to the --  
22 the issue between the DCAT assumptions and -- and the  
23 assumptions used to set our equity return forecast.

24 So the issue around our equity return  
25 assumption is to get a reasonable long-term equity

1 return forecast in -- in our -- in our GRA. We -- we  
2 don't attempt to -- there's -- there's a wide variety  
3 of opinions on what equities are going to do next year  
4 or the year after, and there's no -- at least to my  
5 knowledge, no reasonable method of taking the average  
6 of a bunch of peoples different assumptions and  
7 including that in our forecast.

8           So we -- when we looked at our existing  
9 method for equity forecasting we used a equity risk  
10 premium of the -- of 1 1/2 percent above the Canadian  
11 ten (10) year bond yield. And recognizing that these  
12 yields are at some of their lowest levels in history,  
13 we looked at the output from that exercise and said, Is  
14 it -- is it really reasonable for the Corporation to --  
15 to forecast a 4.8 percent equity return in the GRA.

16           So we went through an exercise of  
17 saying, What is a reasonable long-term return based on  
18 the data we had available. And we judgmentally  
19 selected twenty (20) years as a -- as a reasonable  
20 period of time. And it's over that -- over rolling  
21 twenty (20) year periods we've seen that the return as  
22 the -- again, the never falling below 5.2 percent  
23 compounded return, and the 5th percentile at six point  
24 one (6.1).

25           So that piece was the evidence we needed

1 to say that, you know what, four point eight (4.8) --  
2 we could just blindly apply our existing way of  
3 forecasting but that wouldn't really, you know, relate  
4 to the history that's -- that -- that we have. So we -  
5 - we made a proposal to change that to use this minimum  
6 equity return, and -- and so we got a much more  
7 reasonable forecast in there.

8 Relating to the -- the DCAT, there's a -  
9 - very different reasons for the -- the two (2)  
10 assumptions. So one -- one we're looking at a -- the  
11 long-term equity return. And we see that we have some  
12 fairly consistent results over longer terms.

13 For the DCAT we're looking at shocks,  
14 significant declines over the period that's applicable  
15 to MPI's rating. So that's -- that's great if we can  
16 earn a 5.2 percent return over twenty (20) years. And  
17 this -- this data is suggesting that it's -- it's  
18 likely. But there are ups and down -- significant ups  
19 and downs in there. And we're trying to protect in the  
20 RSR is the impact on ratepayers from those significant  
21 increases and -- and decreases.

22 So if we were to look at, as we've done  
23 in the DCAT, shorter snapshots of equity returns,  
24 you'll see periods where it's been down forty (40) and  
25 periods where it's been up forty (40), all working out

1 to this 5.26 percent or so average yield over time. So  
2 I think two (2) very different -- different purposes.  
3 And that -- that, hopefully, explains where we're  
4 coming from there.

5 I just need a moment to respond to your  
6 second question.

7

8 (BRIEF PAUSE)

9

10 MS. MARILYN MCLAREN: Maybe if I could,  
11 Mr. Chairman, different -- come at the same information  
12 a little bit different perspective while Mr. Johnston  
13 gathers his thought on the second question.

14 If I can paraphrase -- paraphrase the  
15 question, it's: Why are you making such fundamentally  
16 different assumptions about equities in these two (2)  
17 different processes? Because they are fundamentally  
18 different processes, right. I mean, the first is  
19 forward-looking rate-making. And I think -- I don't  
20 think we'd have any credibility; it wouldn't be  
21 appropriate if we came here and said, Well, we think  
22 next year is really going to be the really bad year.

23 And we -- we always forecast and do our  
24 rate-making based on the average. The -- within the  
25 rate-making methodology, we average serious losses over

1 a very long period of time. We average -- when looking  
2 at the past, we average investment income over a period  
3 of time. We look at the forecast of inflation and in -  
4 - and interest rates, like we've told. But we always  
5 forecast rates based on a normal year.

6                   Trying to make -- trying to determine  
7 how much capital we need to protect ratepayers from  
8 rate shock is a fundamentally different process.  
9 You're purposely looking for plausible adverse  
10 scenarios: What are the things out there that can risk  
11 that capital?

12                   As -- and if -- and if you don't think  
13 there are any, if you think we'll always, for the  
14 foreseeable next fifty (50), hundred years we'll just  
15 have normal results, then we probably don't need an  
16 RSR. So they're fundamentally different purposes and  
17 you come at them differently. What do we normally  
18 expect in a normal year is a question we're answering  
19 for rate-making.

20                   In term -- determining the size of the  
21 RSR, what are plausible risks that could destroy the  
22 capital and cause rate shock for ratepayers to recover  
23 the capital?

24                   MR. LUKE JOHNSTON: In -- in regards to  
25 your second question, I -- I believe it was about that

1 we have some evidence that -- that -- indicating that  
2 our equity managers perhaps performed slightly below  
3 the index. We did not go forward with that assumption  
4 that that would continue. That's -- we assume  
5 basically the same, they'll maintain the index for the  
6 -- for forecasting purposes.

7

8 CONTINUED BY MR. BYRON WILLIAMS:

9 MR. BYRON WILLIAMS: Thank you. Mr.  
10 Johnston, I -- I want to, just in terms of your  
11 response to the chairman -- and we'll get more into the  
12 equity assumption tomorrow -- but you seem to be  
13 suggesting that since 1956 there had been a cumulative  
14 four (4) year return period with negative results on  
15 the range of minus 40 percent.

16 Can you point to a single cu --  
17 cumulative four (4) year return on the TSX since 1956  
18 of negative 40 percent, sir?

19 MR. LUKE JOHNSTON: I don't believe I  
20 made that reference; but if I did, I apologize. The --  
21 I -- I may have said that they're -- that equities  
22 could have shown to swing either way; sometimes  
23 negative forty (40), sometimes plus forty (40) might --  
24 may have been my -- my reference.

25 Four (4) -- four (4) year periods since



1 1956, no, there's not a negative four (4) -- 40 percent  
2 cumulative return over four (4) years. How -- however,  
3 the -- let me find my reference here...

4 Three (3) years ago we had a two (2)  
5 year return of more than negative forty (40). That's  
6 essentially the -- the same period that I'm assuming  
7 the DCAT -- the recogni -- recognition of equity  
8 losses occurs.

9 We also saw approximately a 38 percent  
10 decline as early as '02 over a two (2) year period, and  
11 again in 1982. So no four (4) year periods over a --  
12 over the last -- or, since 1956 but several two (2) and  
13 -- and three (3) year for cumulative returns.

14 MR. BYRON WILLIAMS: But, sir, of  
15 course the -- the heart of your DCAT analysis was that  
16 cumulative four (4) year analysis, correct?

17

18 (BRIEF PAUSE)

19

20 MR. BYRON WILLIAMS: That's the  
21 methodology you chose, sir, because you wanted to  
22 partially account for the impact of declined recovery  
23 scenarios. That's why you chose it.

24 MR. LUKE JOHNSTON: Yes. The -- so as  
25 a -- as evidence to support a selection of negative 40

1 percent, we looked at four (4) year periods to try to  
2 have an understanding of a prolonged equity decline  
3 events. And so you'll notice in -- in the report, as  
4 well, I -- I don't chose the -- the 5th percentile is  
5 approximately negative 43 percent. I don't select  
6 negative 43 percent. The -- the 1st percentile is --  
7 is approximately negative 70 percent. I haven't  
8 selected that either.

9           The -- the issue here is not that I  
10 don't recognize Professor Simpson's evidence that  
11 there's a difference in the variability of equity  
12 losses after 1956, but rather whether I should do what  
13 is suggested by Professor Simpson and completely ignore  
14 all the data prior to 1956.

15           So in my selection, I think it's evident  
16 that I've given some weight to the lack of very  
17 significant declines over that period since 1956, but I  
18 don't think it's right to just completely ignore that  
19 history.

20           MR. BYRON WILLIAMS: I thank you for  
21 that, and we'll revisit this tomorrow. In terms of a  
22 small matter, directing your attention to CAC Exhibit  
23 5, page 23 -- and we've discussed this off -- offline,  
24 you'll recall, Mr. Johnston.

25           Under, "Scenario Justification," you see

1 the -- the description of the 5th percentile event as  
2 being minus 43.2 percent. Do you see that, sir?

3 MR. LUKE JOHNSTON: Yes, I do.

4 MR. BYRON WILLIAMS: And if you flip to  
5 the next page, being page 24, in the top right-hand  
6 corner, you're going to see a description which appears  
7 to be of a similar event, being minus 42.75 percent.

8 Do you see that, sir?

9 MR. LUKE JOHNSTON: Yes, I do.

10 MR. BYRON WILLIAMS: And first of all,  
11 are we talking about the same event there?

12 MR. LUKE JOHNSTON: Yes. As you -- as  
13 you can see, these are -- are, of course, very -- very  
14 close, in terms of the impact. I'm investigating to  
15 see exactly how the particular number was quoted.

16 For example, there's -- we build a model  
17 of equity returns, and that -- the quoted number here  
18 may be the -- the model result versus the actual 5th  
19 percentile. If that's the case, they are also -- they  
20 -- they are fairly close.

21 Another issue may have to do with --  
22 with timing. And that's unfortunate that these numbers  
23 don't -- don't match. But that -- partic --  
24 particularly in the IRs, if we're asked to evaluate a  
25 certainly percentile, I -- my -- our investment

1 department likely did that as of that particular point  
2 in time.

3                   So I'll investigate those numbers for  
4 you and -- and let you know what the -- the reason for  
5 the differences are.

6                   MR. BYRON WILLIAMS:     Just for my  
7 clarification, you'll recall that in the response to  
8 PUB-1-60, the Corporation provided the historical  
9 analysis on -- on which it relied for its  
10 identification of the 5th percentile event.

11                   Do you recall that, sir?

12                   MR. LUKE JOHNSTON:     I'm just going to  
13 go to that question.

14

15   (BRIEF PAUSE)

16

17                   MR. LUKE JOHNSTON:     Are you referring  
18 to Part D, where we provide the history?

19                   MR. BYRON WILLIAMS:     Yes, sir.

20                   MR. LUKE JOHNSTON:     I am there.

21                   MR. BYRON WILLIAMS:     Should I expect to  
22 see one (1) or both of those figures, whether it's  
23 forty-three (43) point minus -- forty-three point two  
24 (43.2) or minus forty-two point seven-five (42.75), in  
25 that -- in that information?

1 MR. LUKE JOHNSTON: Likely not. If you  
2 -- if -- if we're modelling this history, then the  
3 output is likely the percentile from the model. I --  
4 yeah, I -- I can do the calculations offline and let  
5 you -- let you know what I get from that. I would  
6 expect it to be, again, very close to -- to negative 43  
7 percent.

8 MR. BYRON WILLIAMS: Mr. Chairman, just  
9 in terms of a time frame, I have many questions yet to  
10 go. But I'm just wondering the Board's intention for  
11 today?

12 THE CHAIRPERSON: Well, I was thinking  
13 we would go right to one o'clock, unless people want a  
14 break. Let's keep going, I think, is my view.

15 MR. BYRON WILLIAMS: Sir, Mr. Chair, if  
16 I could suggest that we stand down for cosmetic reasons  
17 for roughly three (3) minutes. And while we do so if,  
18 Mr. Johnston, you may just want to have at hand pages  
19 542 through 544 of the transcript.

20 Would that be permissible, Mr. Chair?

21 THE CHAIRPERSON: Absolutely. Three  
22 (3) minutes, then.

23

24 --- Upon recessing at 11:44 a.m.

25 --- Upon resuming at 11:51 a.m.

1 CONTINUED BY MR. BYRON WILLIAMS:

2 MR. BYRON WILLIAMS: Yes, thank you for  
3 the -- the break, Mr. Chair. Mr. Johnston, I had  
4 directed your attention to the transcript pages 542  
5 through 544. I haven't put them in the materials for  
6 the -- the tribunal.

7

8 (BRIEF PAUSE)

9

10 MR. BYRON WILLIAMS: In the six (6)  
11 minutes that we've given you, Mr. Johnston, you have no  
12 doubt memorized this material. But as you review it,  
13 I'm sure you will recall a -- a discussion you had with  
14 My Friend, Ms. Grammond, at -- when she was probing you  
15 on your definition of "satisfactory financial  
16 condition".

17 Do you recall that conversation?

18 MR. LUKE JOHNSTON: Yes, I do.

19 MR. BYRON WILLIAMS: And just to  
20 refresh everyone's memory, as I understand it, for the  
21 purposes of your DCAT analysis:

22 "The Corporation's financial  
23 condition is satisfactory if,  
24 throughout the forecast period, it is  
25 able to meet all of its future

1 obligations under the base scenario  
2 and all plausible adverse scenarios,  
3 and -- and under the base scenario it  
4 meets the minimum regulatory capital  
5 requirement."

6 Is that the definition you employed,  
7 sir?

8 MR. LUKE JOHNSTON: Yes, it is.

9 MR. BYRON WILLIAMS: And you'll recall  
10 as well, My Friend, Ms. Grammond, suggesting to you  
11 that that type of question and that type of analysis  
12 sounded a lot like you were focussing on solvency.

13 Do you recall that suggestion?

14 MR. LUKE JOHNSTON: I recall the  
15 solvency discussion, yes.

16 MR. BYRON WILLIAMS: And I'm going to  
17 say you conceded, but -- you -- you may not accept  
18 that. But you -- you agreed that the -- that while --  
19 the particular definition seemed to indicate a solvency  
20 basis.

21 Do you recall that, sir?

22 MR. LUKE JOHNSTON: In terms of the  
23 requirement to keep the rate stabilization reserve  
24 above zero, I had indicated that that may appear to  
25 look like a solvency test.

1 MR. BYRON WILLIAMS: And we'll come to  
2 the -- the other part of your -- your answer, sir. But  
3 just focussing on private-sector companies, I'll --  
4 I'll suggest to you that you would not disagree that  
5 when employed by private-sector companies in a  
6 competitive marketplace, the primary purpose of the  
7 DCAT is to determine if there is a plausible risk of a  
8 solvency issue.

9 Would that be fair?

10

11 (BRIEF PAUSE)

12

13 MR. LUKE JOHNSTON: Yeah, that -- the --  
14 - the primary purpose of the -- the DCAT would of  
15 course be to understand the risks of the -- the  
16 enterprise, how the future financial condition compares  
17 to the regulatory targets of OSFI, not necessarily a --  
18 the company going insolvent, but falling below those --  
19 those targets. And it's -- it's, of course, important  
20 to know if there are plausible adverse scenarios that  
21 could put the Corporation into a -- a negative retained  
22 earnings position.

23 And the -- the DCAT requires that all --  
24 understandably, all those scenarios are laid out in  
25 detail in the report so it can be understood why such a



1 scenario could occur for -- for that company.

2 MR. BYRON WILLIAMS: And that indeed is  
3 a central element of -- of the DCAT analysis.

4

5 (BRIEF PAUSE)

6

7 MR. LUKE JOHNSTON: My apologies.  
8 Could you repeat your last question? Or ask a new  
9 question if you didn't have one.

10 MR. BYRON WILLIAMS: Just so I  
11 understand, first of all, you're -- you're not changing  
12 your answer to the last -- last question, are you, Mr.  
13 Johnston?

14 MR. LUKE JOHNSTON: No, I'm not  
15 changing the -- the substance to my -- my last  
16 question. I -- I didn't want to imply that it was  
17 purely just a solvency test.

18 MR. BYRON WILLIAMS: And I certainly  
19 never understood that to be. But you certainly would  
20 not deny that, in the context of a private-sector  
21 corporation in a competitive environment, that's  
22 certainly one outcome and one important element of that  
23 examination?

24 MR. LUKE JOHNSTON: Yeah, solvency is a  
25 -- is a important element, yes.

1

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(BRIEF PAUSE)

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(BRIEF PAUSE)

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MR. BYRON WILLIAMS: And the nature of DCAT, in terms of its design and the range of plausibility outcomes, it has certainly been designed with that -- with recognizing that -- that the solvency issue is one of the issues in play for private-sector companies in the competitive marketplace?

MR. BYRON WILLIAMS: Mr. Johnston, I'm going to have to have the court reporter repeat that question, because it was a while ago.

MR. LUKE JOHNSTON: Thank you.

MR. BYRON WILLIAMS: I'll -- I'll take another shot at it. Inherent in the DCAT design and the plausibility range is a recognition that one of the aspects of this analysis is a consideration of its impacts on solvency of private-sector companies in a competitive marketplace?

1 MR. LUKE JOHNSTON: I'm unclear how to  
2 draw that comparison between the DCAT performed for  
3 Basic, Autopac, MPI, and -- and the private sector  
4 regulatory capital requirements.

5 The RSR of greater than zero is a target  
6 used in the DCAT. The definition of "satisfactory  
7 financial condition" is as per the regulatory re --  
8 capital requirements of this Board, not private sector.

9 The -- the DCAT is recommendation --  
10 recommended risk level is no different than the -- the  
11 risk analysis asking for 190 to 300 million excess  
12 retained earnings. Here we're adding -- we're  
13 essentially adding a risk margin above an assumed RSR  
14 level of zero and asking what -- how much do we need  
15 above zero to maintain satisfactory financial condition  
16 in all scenarios.

17 The -- the Corporation is not suggesting  
18 in any way that this is a solvency test for us, or that  
19 we've somehow become insolvent. It's -- it's about the  
20 stated purpose of the RSR and preventing rate shock for  
21 policy holders.

22 MR. BYRON WILLIAMS: Mr. Johnston, my  
23 question may have been unclear, so let me -- let me try  
24 it again.

25 We agree that -- under the DCAT approach

1 an adverse scenario would be considered plausible if it  
2 reflects the 95th to 99th percentile of outcomes,  
3 agreed?

4 MR. LUKE JOHNSTON: Agreed. This would  
5 be the -- the risk tolerance of the DCAT similar to  
6 other methods.

7 MR. BYRON WILLIAMS: And I'm suggesting  
8 to you that in the inherent -- in the design of that  
9 range of risk tolerance is a recognition that when this  
10 is being used by a private-sector company in a  
11 competitive marketplace, solvency is an issue. It's  
12 the DCAT range I'm focussing on, sir, not your  
13 Application here.

14

15 (BRIEF PAUSE)

16

17 MR. LUKE JOHNSTON: If you're asking  
18 does the DCAT show in which scenarios with a one (1) in  
19 twenty (20) to one (1) in a hundred (100) probability  
20 of occurrence could push the private company below the  
21 regulator's capital requirements, or potentially push  
22 them into insolvency position, then that is what the --  
23 the DCAT would show for a private company. That's not  
24 -- that's not the requirement in this province, and  
25 it's -- we're not comparing ourselves to that.

1 MR. BYRON WILLIAMS: And I won't  
2 belabour the point, Mr. Johnston, but I'm going to  
3 suggest to you that that one (1) in one hundred (100)  
4 scenario is, in terms of the breadth of the  
5 plausibility range, is a reflection of the fact that  
6 the DCAT is designed to -- in contemplation of that  
7 solvency issue.

8 MR. LUKE JOHNSTON: I would disagree  
9 with that. I -- if the -- if you're suggesting that  
10 the Board's one (1) in forty (40) risk tolerance level  
11 has anything to do with solvency of MPI, I don't think  
12 that does any more than the risk tolerance level we're  
13 selecting in the DCAT. It's about the -- the level of  
14 risk that you're willing to accept and how MPI would  
15 have to respond if those scenarios occurred.

16 MR. BYRON WILLIAMS: Now, Mr. Johnston,  
17 when we were talking -- chatting about your discussion  
18 with Ms. Grammond a few moments ago while you  
19 acknowledge that -- that the DCA -- DCAT -- and I'll --  
20 I'll be careful with my language here -- seemed to  
21 indicate a solvency basis, without asking you to  
22 elaborate, you also indicated that in your view its  
23 purpose is very consistent with the purpose of the RSR  
24 in that, to quote you:

25 "It significantly prevents rate

1 shock."

2 Do you recall that?

3 MR. LUKE JOHNSTON: I don't recall  
4 those exact words, but the -- the DCAT, we've -- we've  
5 stated multiple times in the evidence is -- explicitly  
6 measures the risk of MPI and ties in almost perfectly,  
7 in my opinion, if not perfectly, with the purpose of  
8 the RSR. That is to prevent rate changes from  
9 significant events, such -- such as the ones we're  
10 outlining in the report.

11 MR. BYRON WILLIAMS: And you went on to  
12 -- to say, at page 543, if you're looking, sir, that if  
13 we do fall to a negative RSR position, we will be  
14 required to rebuild to recover our retained earnings.

15 And that -- that will require rate  
16 increases or rate surcharges, correct?

17 MR. LUKE JOHNSTON: I would assume,  
18 based on the past precedent and how we set rates in  
19 this province, that we would not run at a negative  
20 retained earnings position for a prolonged period. I  
21 would expect that we would have rate surcharges or rate  
22 increases in -- in whatever way necessary to get to the  
23 Board's capital requirement, be it DCAT or any other  
24 method.

25 MR. BYRON WILLIAMS: And we'll come to

1 that in just a moment, sir. Turning to page 25 of CAC  
2 Exhibit 5, you'll see the response to CAC-1-3.

3

4 (BRIEF PAUSE)

5

6 MR. LUKE JOHNSTON: Page 25?

7 MR. BYRON WILLIAMS: Page 25, in the  
8 top right-hand corner, Mr. Johnston.

9 MR. LUKE JOHNSTON: Thanks.

10 MR. BYRON WILLIAMS: Now, this -- (c)  
11 sets out the adverse scenarios. And, Mr. Johnston,  
12 we'll leave the discussion of the decline in equity  
13 markets till tomorrow.

14 But of the three (3) other adverse  
15 scenarios, the -- amongst the top four (4) -- those  
16 being the combined incurred/equities, a high loss  
17 ratio, and a large hail storm -- MPI describes all of  
18 these as one (1) in one hundred (100) year probability  
19 levels, correct?

20 MR. LUKE JOHNSTON: That's correct.

21 MR. BYRON WILLIAMS: And it is your  
22 professional judgment that in order to significantly  
23 protect ratepayers against rate shock, you have to set  
24 up reserves that protect them from the possibility of  
25 one (1) in one hundred (100) year events?

1 Is that your view, sir?

2 MR. LUKE JOHNSTON: Well, we -- we do  
3 have to select -- again, we have to select a risk  
4 tolerance. And this is the risk tolerance used in the  
5 DCAT. The occurrence -- the event that occurs does not  
6 have to be one (1) in one hundred (100). A eighty  
7 (80), \$90 million decline produced by some of these  
8 other scenarios, or through -- for any combination of  
9 reasons would also be something that could generate a -  
10 - a rate surcharge.

11 There's obviously the full spectrum of  
12 possible outcomes between our best estimate and the  
13 99th percentile.

14 MR. BYRON WILLIAMS: I -- I may not  
15 have asked my questions clearly. So I'll just ask it  
16 again, and then you can choose to answer it if you  
17 wish.

18 Is it your professional judgment that in  
19 order to significantly protect ratepayers against rate  
20 shock, you have to set up reserves that protect them  
21 from the possibility of one (1) in (100) year events?

22

23 (BRIEF PAUSE)

24

25 MR. LUKE JOHNSTON: Just to make sure



1 I'm clear, would you mind repeating the -- the  
2 question?

3 MR. BYRON WILLIAMS: Mr. Johnston,  
4 you're asking a lot of me to repeat it three (3) times,  
5 but I think this one I can handle.

6 Is it your professional judgment that in  
7 order to, using your words, "significantly protect  
8 ratepayers," end your words, against rate shock, you  
9 have to set up reserves that protect them from the  
10 possibility of one (1) in (100) year events?

11 MR. LUKE JOHNSTON: Yes, I believe that  
12 to be true. This, and -- this in -- as you've shown on  
13 this page, this is the -- essentially the -- the risk  
14 tolerance level that I've selected.

15 MR. BYRON WILLIAMS: Has the  
16 Corporation tested that proposition with Manitoba  
17 seniors, namely that they would like to keep their  
18 money in -- in the Corporation's retained earnings to  
19 protect them against one (1) in one hundred (100) year  
20 events?

21

22 (BRIEF PAUSE)

23

24 MR. LUKE JOHNSTON: No, I did not  
25 consult -- I -- I believe you quoted them, "Manitoba

1 Society of Seniors." No.

2 MR. BYRON WILLIAMS: I couldn't have  
3 done that. I don't think they exist anymore, Mr.  
4 Johnston. I'm just wondering: Has -- has the  
5 Corporation put this to seniors or other Manitobans,  
6 this proposition?

7 MR. LUKE JOHNSTON: No, I did not -- I  
8 -- I did not, and the Corporation did not. As part of  
9 this risk based analysis, we did not poll the public  
10 for their -- their view on our selected risk tolerance.

11 MR. BYRON WILLIAMS: Mr. Johnston, in  
12 your discussion with Ms. Kalinowsky oh so long ago on  
13 the first day of the Hearing, you referred to this DCAT  
14 as a made-in-Manitoba solution appropriating the words  
15 of -- of, I think, one of my witnesses from some time  
16 ago.

17 Do you recall that?

18 MR. LUKE JOHNSTON: Yes, I do.

19 MR. BYRON WILLIAMS: In crafting a  
20 made-in-Manitoba solution, would it be permissible to  
21 employ the -- a DCAT for range between the 95th and the  
22 97.5 percentile?

23 MR. LUKE JOHNSTON: We did talk a  
24 little bit on that topic, and the one (1) and forty  
25 (40) year risk tolerance level, the 97.5 percent --

1 percentile does fall within the DCAT requirements, and  
2 we can model those scenarios.

3                   And we did talk a little bit last week  
4 also about a more collaborative approach and have  
5 indicated that we're quite willing to work with the  
6 Board and Intervenors on developing scenarios that meet  
7 the standards required of the DCAT process while also  
8 reflecting the -- the concerns of the parties in the  
9 room and -- and perhaps, as well, the -- the risk  
10 tolerance level of the Board.

11                   Again, I'm trying to -- or, pardon me,  
12 not trying -- keeping those -- any assumptions that we  
13 make within the actuarial standards of designing the  
14 DCAT.

15

16                   (BRIEF PAUSE)

17

18                   MR. LUKE JOHNSTON:   And perhaps if I --  
19 I could clarify. I also mentioned that as a  
20 professional, I have to be able to be willing to accept  
21 the assumptions that we're using. It in no way means  
22 that I -- we -- the Corporation can't provide the Board  
23 with the information that it requires for a particular  
24 scenario.

25                   I just will not produce a DCAT if I

1 believe that the underlying assumptions are flawed or -  
2 - or not acceptable.

3 MR. BYRON WILLIAMS: Thank you, Mr.  
4 Johnston. Ms. McLaren, you were -- in your evidence  
5 yesterday, you were discussing the contribution of the  
6 Gartner Group to Manitoba Public Insurance.

7 And I don't know if you recall a  
8 discussion in which you were discussing the  
9 applicability of some of Gartner Group's private-  
10 sector-driven analysis. But I'll ask you if you recall  
11 stating something to the effect that sometimes the  
12 lenses do not always align.

13 Do you remember a statement to that  
14 effect, Ms. McLaren?

15 MS. MARILYN MCLAREN: I do.

16 MR. BYRON WILLIAMS: Could it be said  
17 that in applying a one (1) in one hundred (100) year  
18 event solvency test to a rate shock issue, sometimes  
19 the DCAT lenses do not always align?

20 MS. MARILYN MCLAREN: No, I don't think  
21 so, because you have to look at a little bit broader  
22 context than that. If we were before this Board -- you  
23 know, remembering that part of what we're trying to do  
24 is to work with this regulatory framework, right, I  
25 mean, I think you can -- you cannot understate the

1 importance of your conversations and your perspectives  
2 around solvency without considering the importance of  
3 the fact that any private-sector company that gets  
4 anywhere close to the 150 percent on the MCT score is  
5 automatically under supervision.

6 I mean, if we were here saying, Well,  
7 you know, you need a much, much bigger RSR, according  
8 to some private-sector model, even back in the day when  
9 we were suggesting that the MCT would be a good basis  
10 to select the RSR, we weren't talking 150 percent. We  
11 were saying between 50 and a hundred percent might be  
12 appropriate for the Basic compulsory program.

13 So to choose the -- the different  
14 features in a -- in a similar actuarial methodology  
15 without considering how we truly have used that  
16 methodology to the circumstances specific to Manitoba,  
17 I -- I don't know that those are -- I -- I just don't  
18 agree with the basis of your question in that case.

19 MR. BYRON WILLIAMS: Thank you for  
20 that. Mr. Johnston, just going back to the -- your  
21 words -- and, again, if you're looking for a reference,  
22 it's page 543, line 2 -- "significantly prevents rate  
23 shock."

24 Do you define "rate shock" to be a rate  
25 increase of 10 percent or more within a fiscal year?

1

2

(BRIEF PAUSE)

3

4

MR. LUKE JOHNSTON: Although  
5 significant, I -- I wouldn't classify that as a rate  
6 shock.

7

MR. BYRON WILLIAMS: How high would you  
8 go, Mr. Johnston? It's your words.

9

MR. LUKE JOHNSTON: We do have  
10 guidelines that we -- that we use for rating to limit  
11 the size of increases after 10 percent, capping  
12 experience at fifteen (15) and, as an absolute limit,  
13 20 percent increases to rates.

14

Again, such increases are clearly not --  
15 not desirable, but that's the approach we've taken if  
16 the underlying claims experience indicates that such a  
17 rate increase is needed.

18

MS. MARILYN MCLAREN: Let's -- we can  
19 go back the other way, as well, in terms of less than  
20 10 percent, if you're talking about the entire fleet,  
21 the entire population of Manitoba vehicles. After a  
22 cumulative -- I think it's about 12 percent rate  
23 decreases in the last year, if we turned around and  
24 said, you know, we need 6 percent more now, that may  
25 very well qualify as well. Things like this are -- are

1 situational.

2                   We don't use a lot of hard and -- and  
3 fast numerical benchmarks, in terms of those -- some of  
4 those definitions. What we're talking about is making  
5 sure this compulsory automobile insurance program  
6 continues to meet the needs of Manitobans for  
7 predictability and stability. That's what we're  
8 talking about here.

9                   So what Mr. Johnston has said a number  
10 of times and what we believe is the DCAT is the best  
11 approach possible to determine the RSR according to the  
12 definition of the RSR, which doesn't necessarily tie  
13 directly to rate shock, right. It's about protecting  
14 Manitobans from one (1) time events.

15

16   (BRIEF PAUSE)

17

18                   MR. BYRON WILLIAMS: I could have sworn  
19 that -- that it was the actuary who used the word  
20 "significantly prevents rate shock."

21                   Was that -- that was you, Mr. Johnston?

22

23   (BRIEF PAUSE)

24

25                   MR. LUKE JOHNSTON: The -- I do believe

1 that the -- the DCAT methodology will aid in preventing  
2 significant rate increases, rate shocks. I -- I don't  
3 -- I don't -- I haven't defined "rate shock".

4 But the -- the -- again, the stated  
5 purpose of the RSR doesn't specifically address rate  
6 shock, but rather rate increases made necessary by  
7 unexpected events, such as the ones in the -- in the  
8 DCAT.

9 I believe that an adequate RSR level, as  
10 set by the DCAT, would significantly reduce the  
11 probability that ratepayers have to have rate increases  
12 from these events versus selecting another method, for  
13 example, that's significantly lower.

14 MR. BYRON WILLIAMS: So if I understand  
15 your last answer, Mr. Johnston, when we think of the  
16 RSR target, we should think of it as pre-collecting  
17 money to avoid rate increases arising from unforeseen  
18 events, regardless of whether rate shock will ensue or  
19 not?

20 MR. LUKE JOHNSTON: I'm a little bit  
21 unclear with your question, so I -- I just -- I just  
22 spoke that the stated purpose of the RSR is to prevent  
23 -- to protect motorists from rate increases made  
24 necessary by unexpected events and losses.

25 So I've said that that -- that is one of



1 the reasons why the DCAT ties so well with that  
2 definition, because, again, we're looking at the  
3 specific risks that -- that MPI faces and -- and how  
4 those risks would impact policy holders. So I'm not  
5 clear on what you're asking.

6 MR. BYRON WILLIAMS: I'll reflect on  
7 that, Mr. Johnston. I do thank MPI for assisting our  
8 clients in understanding their position. Ms. McLaren -  
9 - and, Mr. Chairman, I will come back to some of these  
10 questions tomorrow. But just while Ms. Desorcy is --  
11 is here, I do have some questions about the direction  
12 of the -- the road -- road safety initiatives.

13 And -- and certainly, our clients read  
14 with -- with interest your thoughtful commentary in --  
15 in a number of the publications you have.

16 And I -- I'm going to just start with a  
17 -- a lengthy question, in terms of -- it won't be the  
18 first or the last, Ms. McLaren, but when -- when one  
19 looks at the potential roles that Manitobans have  
20 suggested for Manitoba Public Insurance, one of them  
21 obviously is a -- and I'm going to go through them one  
22 (1) by one (1).

23 But one obviously is a -- as an investor  
24 in road safety programming, similar to what you're  
25 doing today?

1 MS. MARILYN MCLAREN: Sure, that's  
2 fair.

3 MR. BYRON WILLIAMS: And another is a -  
4 - as a coordinator of groups working in this road  
5 safety role? We've seen that in your documentation?

6 MS. MARILYN MCLAREN: Yes, that's fair.  
7 I -- I don't know that there's complete clarity on what  
8 everyone would mean by "coordinator", but that's fair.

9 MR. BYRON WILLIAMS: There's also been  
10 a suggestion that Manitoba Public Insurance should act  
11 as a central repository to facilitate sharing of data?

12 MS. MARILYN MCLAREN: Yes.

13 MR. BYRON WILLIAMS: That it should  
14 promote or support a research centre focussed on  
15 Manitoba specific issues and be a coordinator of  
16 evaluation of programs, correct?

17 MS. MARILYN MCLAREN: There was some  
18 feedback along those lines, yes.

19 MR. BYRON WILLIAMS: It was suggested  
20 it should be an educator, with more extensive and  
21 challenging programming, whether field tests, online  
22 delivery of programming, and greater use of technology,  
23 such as simulations, correct?

24 MS. MARILYN MCLAREN: Yes.

25 MR. BYRON WILLIAMS: Some have

1 suggested it should be an investor in enforcement,  
2 correct?

3 MS. MARILYN MCLAREN: Some, yes.

4 MR. BYRON WILLIAMS: Others have  
5 suggested infrastructure?

6 MS. MARILYN MCLAREN: Yes.

7 MR. BYRON WILLIAMS: And the City of  
8 Winnipeg and the MTA seem quite keen on you doing road  
9 safety audits in high-collision areas?

10 MS. MARILYN MCLAREN: That's fair.

11 MR. BYRON WILLIAMS: So, Ms. McLaren,  
12 obviously there's tremendous opportunities for the  
13 Corporation and for Man -- Manitobans in this  
14 discussion.

15 I wonder if you could assist my client  
16 in identifying what you see as some of the risks for  
17 the Corporation?

18 MS. MARILYN MCLAREN: I guess in the  
19 broadest sense my answer to that would really follow on  
20 some of the conversation that I had with the Chairman  
21 yesterday. This is such a broad area. There are so  
22 many terrific ideas. The risk is that the spending can  
23 certainly get out of control. You have to be very  
24 careful at being clear on what you really believe might  
25 be investments versus what might truly be expenditures.

1 I think there are also risks associated  
2 with becoming a bit misaligned with what Manitobans  
3 would really see as our role if we were too pervasive  
4 or aggressive about moving into this area. There are  
5 some really mixed feelings out there in the population  
6 about the extent to which we should fund enforcement.  
7 There are absolutely strong support in some key risky  
8 behaviours, but not so much in others.

9 So I think overall we are always very,  
10 very focussed on -- on working hard to stay aligned  
11 with what Manitobans believe is appropriate. And I  
12 just think in this area, really making sure the  
13 expenditures are prudent, identifying investments where  
14 you can, but recognizing that a lot of this is -- is a  
15 very, very uncertain and fuzzy area.

16 MR. BYRON WILLIAMS: Now, in -- in your  
17 view, recognizing your -- your concern with keeping  
18 expenditures prudent and under control, are you  
19 confident that the Corporation's existing road safety  
20 expenditure and -- and oversight controls are robust  
21 enough to do that?

22 MS. MARILYN MCLAREN: While  
23 acknowledging that there's probably always areas to  
24 contin -- to continue to improve, the methodology that  
25 we adopted many years ago as -- before you embark on a

1 particular program, whether it's an advertising  
2 campaign, whether it's a wildlife pilot, what are your  
3 -- what are you hoping to achieve. And, in many cases,  
4 reduced claims cost are not one of the objectives.

5           So if what you're hoping to achieve is  
6 enhanced awareness, higher self-reporting that they  
7 will do something better in the future, and you can  
8 actually measure against those objectives, I think  
9 that's about as much monitoring as you can do in some  
10 cases.

11           So that's the framework we use. I  
12 believe we use it pretty consistently, and I think for  
13 the most part we have -- we've stuck to that program.

14           MR. BYRON WILLIAMS: In terms of other  
15 jurisdictions who MPI may -- may seek to learn from, in  
16 terms of just this expenditure control and -- and  
17 management, is ICBC the -- the leading jurisdiction or  
18 are there others?

19

20   (BRIEF PAUSE)

21

22           MS. MARILYN MCLAREN: No, I -- I think  
23 that's fair to say, that ICBC is certainly recognized  
24 as a leader. And for quite some time they have spent  
25 money or invested in road safety areas that -- that MPI

1 has not. And we would look to learn from them,  
2 particularly in those areas.

3

4 (BRIEF PAUSE)

5

6 MR. BYRON WILLIAMS: Ms. McLaren, we're  
7 going to change gears just a little bit, still in the -  
8 - hopefully in the loss-prevention, enhancing safety  
9 vein.

10 Our client is curious about -- about the  
11 -- the Corporation's research into the driver safety  
12 rating and, in particular, what, if any, insight the  
13 Corporation has, and what, if any, research it has, in  
14 terms of whether consumers are understanding how it  
15 works and what it means?

16

17 (BRIEF PAUSE)

18

19 MS. MARILYN MCLAREN: I would have to  
20 go back to see if we've done anything in terms of  
21 quantitative research along those lines.

22 What I can tell you is that anecdotally  
23 the calls that we get to our call centre, the  
24 conversations that brokers have with Manitobans is they  
25 are very, very much in favour with the new system. The

1 comprehensive but simple and straightforward approach  
2 we've taken to explaining the new system with each  
3 renewal and reassessment that comes up has -- I think  
4 would have to -- the -- the information we have from  
5 the sources I talked about demonstrates to me that it's  
6 working pretty well.

7                   This is the kind of thing that if people  
8 were confused and surprised, we would be hearing about  
9 it. And there's nothing along those lines. Instead,  
10 they're asking fairly informed questions when they do  
11 call or go to the broker to talk about their movement  
12 on the scale.

13

14                   (BRIEF PAUSE)

15

16                   MR. BYRON WILLIAMS: Ms. McLaren,  
17 without putting you to a formal undertaking, if there  
18 is -- if there is research that -- that the Corporation  
19 had -- has done and -- and at the risk of testifying,  
20 flowing from our -- certainly our clients' focus  
21 groups, has the Corporation identified any age gap in  
22 terms of understanding of DSR?

23                   And by that I mean if it has any  
24 surveying, has it looked at whether younger persons who  
25 are less mail-orientated and more online, whether --

1 whether they're grasping the principles of that -- of  
2 DSR?

3 MS. MARILYN MCLAREN: Yeah, if we have  
4 anything we'll bring it forward.

5

6 (BRIEF PAUSE)

7

8 MR. BYRON WILLIAMS: Is the cor -- is  
9 the Corporation undertaking or considering any  
10 education campaigns in terms of the recent Winnipeg  
11 phenomena of traffic circles?

12 MS. MARILYN MCLAREN: We have. We've  
13 done both the sixty (60) second driver spot on them.  
14 We've also run some print advertising in the Free Press  
15 on them. Both of those are currently available under  
16 the driving tip section of our website.

17 I think -- trying to think. There was  
18 one (1) more. Just give me half a second here.

19

20 (BRIEF PAUSE)

21

22 MS. MARILYN MCLAREN: We've also  
23 included it in the dri -- the driver's handbook.

24 MR. BYRON WILLIAMS: Now, we are  
25 jumping around a little bit here, Ms. McLaren. You'll



1 forgive me for this. What, if any, customer research  
2 has Manitoba Public Insurance done in terms of the  
3 desire of consumers to have better information  
4 technology services?

5 And, I guess, the corollary, is it -- ha  
6 -- has any of that research been associated with an  
7 explanation of how it will be paid for?

8 MS. MARILYN MCLAREN: No, we haven't  
9 done any customer surveys to find out if Manitobans  
10 think we should make sure our IT systems keep running  
11 and don't fall over. And I think, by the same token,  
12 we have done -- not done customer surveys to say, Do  
13 you think we should enhance and expand our IT  
14 infrastructure so we can do the kinds of services in  
15 the future we don't do today.

16 We've never done that kind of thing at  
17 MPI. We don't believe that is the best way to stay in  
18 tune with Manitobans. We didn't ask them if we thought  
19 the streamlined renewal process was a good idea. What  
20 we have asked, and the way we come at these things is  
21 to ask if they, you know, support a broader context of  
22 eliminating low-value transactions, making sure we're  
23 available to them when and how they need us to be, not  
24 that we're forcing them to come in and do things  
25 according to our agenda or our schedule. So we come it

1 at a slightly different way.

2 But back to your original question, no,  
3 we haven't done a survey on whether they think we  
4 should spend money on IT.

5 MR. BYRON WILLIAMS: Now, in -- in  
6 terms of MPI's consumer education advertising, have  
7 they had any external reviews of its effectiveness or  
8 benchmarking or comparison against what is working in  
9 other jurisdictions?

10 MS. MARILYN MCLAREN: What was the  
11 first part of that, in terms of the safety advertising?

12 MR. BYRON WILLIAMS: Yeah, consumer  
13 education, safety advertising.

14 MS. MARILYN MCLAREN: Okay. When I  
15 talked about the -- the measures that we establish for  
16 each program, those are all done according to -- and I  
17 don't remember the name offhand, I can get it if it's  
18 important to you, but it -- there is the Advertising  
19 and Public Information Standards Association that says,  
20 Here's how to measure the effective -- we -- we follow  
21 those benchmarks. We follow those guidelines. We --  
22 we don't come up with them on our own.

23 MR. BYRON WILLIAMS: Just a last couple  
24 questions flowing from some of the consumer context of  
25 our client. I think I know the answer to this

1 question.

2 But does MPI do renewals at their  
3 offices and they -- do they advertise this service?

4 MS. MARILYN MCLAREN: Do we do renewals  
5 at our offices? Yes, our service centres do. And, no,  
6 we do not advertise that. We communicate to the  
7 public, for the most part, the services that we provide  
8 directly to Manitobans that are not available from  
9 brokers.

10 Brokers are the -- the primary source of  
11 those Basic insurance and registration related  
12 transactions. We certainly would never not provide  
13 them, but we focus our information to Manitobans on  
14 what -- what we do that brokers cannot do.

15 MR. BYRON WILLIAMS: Mr. Chairman, I've  
16 -- I haven't taken all your time. I can certainly move  
17 to another area. I'm not sure that I have anything --  
18 I could probably kill a few more minutes on a couple of  
19 other subjects. It's up -- up to you, sir.

20 THE CHAIRPERSON: Please do.

21

22 (BRIEF PAUSE)

23

24 CONTINUED BY MR. BYRON WILLIAMS:

25 MR. BYRON WILLIAMS: Sorry about that,

1 court reporter. Mr. Johnston, back to you at page 28  
2 of the -- of the CAC number 5.

3 Do you have that, sir?

4 MR. LUKE JOHNSTON: Yes, I do.

5 MR. BYRON WILLIAMS: One of the -- the  
6 concerns expressed by MPI, in terms of the operational  
7 and investment risk analysis, is that setting the RSR  
8 target using a time horizon of two point five (2.5)  
9 years may not be appropriate.

10 Do you recall expressing that concern,  
11 sir?

12 MR. LUKE JOHNSTON: Yes, I do.

13 MR. BYRON WILLIAMS: And I'll suggest  
14 to you that CAC-2-28 asks you to re -- reformulate the  
15 value at risk time horizon from two point five (2.5)  
16 years to one (1) year.

17 Is -- is that your understanding of this  
18 Information Request as well, sir?

19 MR. LUKE JOHNSTON: That's correct.

20 MR. BYRON WILLIAMS: And the result of  
21 this analysis is that the required RSR based on the  
22 revised analysis is a range of between 170 million and  
23 232 million.

24 Is that correct, sir?

25 MR. LUKE JOHNSTON: Yes, that's

1 correct.

2 MR. BYRON WILLIAMS: Now, sticking with  
3 the -- the risk analysis, the operational investment  
4 risk analysis for a moment or two (2), sir, at the  
5 direction of the -- the Public Utilities Board, that  
6 risk analysis is premised on a -- an investment  
7 portfolio of Manitoba Public Insurance comprised of 25  
8 percent equities.

9 Is that your understanding, sir?

10 MR. LUKE JOHNSTON: Yes, that's correct  
11 and the reference for that would be on -- several  
12 places, but AI.11, part 1, page 6.

13 MR. BYRON WILLIAMS: And the 25 percent  
14 equity, sir, if I understand your evidence in this  
15 hearing, you'll agree with me that it does not reflect  
16 the current reality of Manitoba Public Insurance.

17 I -- in that your portfolio is roughly  
18 60 percent bonds, 20 percent equities, and -- and  
19 roughly another twenty (20) -- 20 percent elsewhere?

20 MR. LUKE JOHNSTON: I won't -- I don't  
21 have in front of me the exact proportions, but you're  
22 correct, it is less than 25 percent.

23 MR. BYRON WILLIAMS: And would I be  
24 correct in assuming, sir, that -- that if the risk  
25 analy -- if the operational and investment risk

1 analysis was modelled on MPI's current equity  
2 portfolio, that the -- the figure and the range would  
3 probably be directionally lower?

4 MR. LUKE JOHNSTON: That's fair. If  
5 you have a -- a lower base then you'd expect a similar  
6 variability with just a -- a reduced number.

7 MR. BYRON WILLIAMS: And, sir, in terms  
8 of the invest -- operational and investment risk  
9 analysis, and the MPI critique of it, would it be fair  
10 to say that in terms of a methodology, Manitoba Public  
11 Insurance has some fairly positive things to say about  
12 value at risk.

13 Would that be fair, sir?

14 MR. LUKE JOHNSTON: Yeah, val -- value  
15 at risk is moving closer towards what we're trying to  
16 do. Again, in the DCAT it's looking at current, or in  
17 this case twen -- we assume 25 percent. But it's  
18 moving to, you know, today's risks. Approximating the  
19 25 percent is the -- of equities is -- is the target.  
20 Unlike the other half of that analysis, it's not based  
21 on historical outcomes or anything like that.

22 In a way, it's -- it's somewhat similar  
23 to the -- the equity analysis that we're doing in the  
24 DCAT. What it's missing is the -- the financial  
25 statement outcomes and management and regulatory

1 action. Yeah, I'll leave it at that.

2 MR. BYRON WILLIAMS: And certainly, in  
3 its own materials -- and if you need a reference it's  
4 AI.11 part -- or, it's -- it's in your discussion of  
5 value of risk. Manitoba Public Insurance describes it  
6 as:

7 "An increasingly valuable tool in  
8 understanding and measuring risks and  
9 a best practice within the  
10 institutional investment industry."

11 Would that be consistent with your  
12 understanding of this tool?

13 MR. LUKE JOHNSTON: Do you have a  
14 reference?

15 MR. BYRON WILLIAMS: Yes, it's -- it's  
16 from -- it's at page 7 of your discussion of -- of  
17 value at risk, sir. Probably right near the con -- the  
18 end of it.

19 MR. LUKE JOHNSTON: I'm not finding it,  
20 but I -- I don't disagree that it's a -- it's a  
21 valuable tool for the -- the purposes for which it was  
22 designed.

23 If -- if I could add to that, one key  
24 aspect of the value at risk that is -- is somewhat  
25 overlooked is it's not comparing itself to budget. So

1 it's saying what is the most the Corporation could lose  
2 over a certain period at a certain confidence level.

3 So if it was to indicate \$200 million,  
4 if we have a budget to make \$50 million, we've actually  
5 -- we're actually at negative 250 million. So that's  
6 one -- one aspect that isn't really discussed much in -  
7 - in this analysis.

8 MR. BYRON WILLIAMS: And in terms of  
9 the range -- or in the -- in terms of the risk  
10 tolerance and, Mr. Johnston, you'll correct me if -- if  
11 I'm wrong on this, but am I correct in -- in suggesting  
12 to you that it's -- that it is designed in terms of a  
13 95 percent probability or ...?

14

15 (BRIEF PAUSE)

16

17 MR. LUKE JOHNSTON: A 95 percent and a  
18 97.5 percent level is produced. I just wanted to make  
19 sure we did both.

20 MR. BYRON WILLIAMS: And I apologize  
21 for that, sir. I should have indicated that. Mr.  
22 Chairman, I'm -- I'm out of any short snappers.

23 THE CHAIRPERSON: Unless we have some  
24 other business to conduct before we adjourn, let's  
25 adjourn now and we'll see each other again tomorrow



1 morning at 9:30. So thank you very much for  
2 accommodating the needs of this particular Board  
3 member. Thank you.

4

5 --- Upon adjourning at 12:52 p.m.

6

7

8

9

10 Certified correct,

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14 Lorraine Douglas, Ms.

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<u>        </u> \$	911:5	997:17	947:20	<b>2009/'10</b>
<b>\$1,000</b>	916:14	<b>1018</b> 898:24	979:6	918:17
944:20,23	921:3	900:16	<u>        </u>	<b>2010</b> 936:20
945:7,16	922:21	<b>11</b> 941:9	<u>        </u> 2	<b>2010/'11</b>
948:12	936:9	955:5	<b>2</b> 898:23	931:9
<b>\$1.49</b> 956:9	944:16	965:23	910:7	<b>2011</b>
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