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 23, 2012

Pages 1542 to 1738

APPEARANCES

| | |
|---|---|
| Candace Grammond | )Board Counsel |
| Kathy Kalinowsky | )MPI |
| Michael Triggs (np) | ) |
| Byron Williams | )CAC |
| Raymond Oakes | )CMMG |
| Liz Peters | )CAA |

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

THE CHAIRPERSON: Good morning, everyone. I believe it's time to resume the proceedings. Unless there's some other administrative issues to address, I believe I'll now turn the mic over to Ms. Kalinowsky to address the rebuttal evidence regarding the Simpson presentation.

MS. KATHY KALINOWSKY: Yes. Good morning. I'm pleased to be here, and have this opportunity. We have circulated a copy of this rebuttal evidence of the Simpson presentation, and it should be marked as Exhibit number 32. I've confirmed that with the Board secretary in advance.

--- EXHIBIT NO. MPI-32: Rebuttal evidence of Simpson presentation

MS. KATHY KALINOWSKY: I can also say that Mr. Pelly is listening via -- electronically, so we actually circulated a copy of this to him electronically this morning just recently, and he does have a copy of it. So he'll be able to follow along too.

But at this point I would like to ask

some questions. We have actually written it all out because we figured it's right at the end of the hearing and not a lot of chance to go through this, in terms of the Intervenors and the Board, prior to their closing later on today.

So if -- rather than just cop -- taking copious notes very quickly, they would just be able to look at this, and it should assist them, and assist the Board, too of course. So I just have it in the form of question and answer with respect to the evidence of Professor Simpson.

MPI PANEL RESUMED:

LUKE JOHNSTON, Resumed

RE-DIRECT EXAMINATION BY MS. KATHY KALINOWSKY:

MS. KATHY KALINOWSKY: But, Mr. Johnston, I'll ask you about the evidence of Simpson, but slide 7 of Professor Simpson's presentation shows the mean and the standard deviation of four (4) year cumulative returns on the TSX for pre-1956 and 1956 and after.

Professor Simpson indicates that the standard deviation, or variability, of equity returns is completely different between these two (2) periods.

Therefore, using all historical period -- TSX periods in the DCAT analysis is flawed.

Do you want to comment on this?

MR. LUKE JOHNSTON: Yes. If -- if I could ask the Board to turn to that slide. It's titled, "Outcomes Differ Pre- and Post-1956," and that's from the Professor Simpson presentation.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: It's about the -- it's about the seventh slide in.

(BRIEF PAUSE)

THE CHAIRPERSON: Pardon me, Exhibit 11, see Exhibit 11?

MR. LUKE JOHNSTON: That's correct.

THE CHAIRPERSON: Okay. And the slide is, "Outcomes Differ Pre- and Post-1956"?

MR. LUKE JOHNSTON: That's right.

(BRIEF PAUSE)

THE CHAIRPERSON: Okay.

MR. LUKE JOHNSTON: As I've stated at the hearings, I believe that it is appropriate to examine all historical periods when determining the expected variability of equity returns.

Professor Simpson continues to reference the pre-1956 and post-1956 periods as the key turning point where equity risks changed. Professor Simpson believes that the pre-1956 equity data carries no weight in the analysis of equity risk because of changes to modern economic stabilization policies which, according to his evidence, significantly changed the level of equity risk.

I fully understand Professor Simpson's evidence, and I see how the Board could look at the two (2) extremes in Professor Simpson's slides and have concerns about these differences.

I also agree that it is reasonable to think that recent events could carry more weight in the equity analysis than older events. To further assist the Board, I've prepared a table, shown on the following page, very similar to Professor Simpsons' on slide 7 of his presentation, which shows the mean and standard deviation of four (4) year cumulative equity returns using a full range of look-back periods, not just pre- and post-1956.

In other words, I've shown the Board the means and standard deviations that would have been calculated using periods of various length range -- ranging from the -- the full period of ninety (90) -- about ninety-two (92) years to the last twelve (12) years, for example, if you use more recent data.

I've also included Professor Simpson's calculation using data from 1956 to present. I'll note, not on this handout, but Professor Simpson does have the entire history of the TSX data, so this information was definitely available to him.

Turning to the table, the second page of the exhibit, what we've done here is the -- the historical periods shown are not specific decades. They're periods of time based on how long we -- we may look back in time. We might decide we want to look back all the way to 1919, but we might decide we want to look all the way back to 1956.

Rather than just show 1956 and the whole history, I've tried to give you, basically, ten (10) years at a time, what -- what the mean and the standard deviation would look like at various points, not just ones that I pick.

So as -- as shown in the table above, the mean and standard deviations of four (4) year equity returns are very consistent over time, regardless of the look-back period. In fact, the standard deviation has actually increased if only the last several decades were considered in the analysis.

You'll also note that the mean and standard deviation from using 1919 to present shows minimal difference between the more recent historical periods. It is clear from the CAC evidence that the data I've provided to the Board -- or, pardon me, and the data I've provided to the Board, that a 40 percent decline in equities over a four (4) year period has not occurred in the recent past.

But as far as the validity of the mean standard deviation argument from Professor Simpson's slides, I see very little difference in the variability of equity returns regardless of which look-back period is used to perform this calculation.

CONTINUED BY MS. KATHY KALINOWSKY:

MS. KATHY KALINOWSKY: The evidence of Professor Simpson -- Professor Simpson provides slide number 8 that suggests that the estimated impact from a four (4) year equity decline of 20 percent is $100 million.

Can you validate these calculations?

MR. LUKE JOHNSTON: Professor Simpson spoke of some, quote, "rougher, back of the envelope," end quote, calculations on the DCAT. Perhaps I can assist the Board using a more sophisticated calculation. I would ask the Board to please turn to AI-9. And, in particular, AI-9, the second page in.

THE CHAIRPERSON: Am I reading the right document? It's called "Investment Allocation"?

MR. LUKE JOHNSTON: That's correct, yeah. On the -- the second page titled "Investment Allocation," in 2013/'14, you'll note that the Basic line of business expects to earn 23.9 million in investment income from equities. So you can find that by going to the '13/'14 table, finding equities. If you scroll across, you'll see --

THE CHAIRPERSON: Just hang on, please.

MR. LUKE JOHNSTON: Yeah.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: So if you go into the '13/'14 table at the bottom of that page, you'll see equities. Moving along that row you'll see expected investment income of 28 million, approximately, for total corporate. And then next to that line you'll see twenty-three, nine sixty-three (23,963). So approximately 23.9 million in equity investment income is expected for Basic line of business.

Following along to the next page you'll see that the Basic line of business is expecting 25.9 million of equity investment income in '14/'15, 28 million in '15/'16, and 30.3 million in '16/'17. The total of these figures is 108.4 million. So if the Corporation had four (4) year equity returns of zero percent, not negative 20 percent, but zero percent, Basic would lose 108 million in equity investment income relative to budget. The Board will note that this figure is already greater than the 100 million presented from Professor Simpson.

The beginning of the year balance for the 2013/'14 Basic equity portfolio is estimated at $372.7 million. This information is on page 20 of the amended DCAT. I don't believe we need -- we need to go there, but that is the figure.

Let's assume that a 20 percent decline, as suggested by Professor Simpson, occurs on the beginning of '13/'14 equity assets of 372.7 million. My calculations indicate that 20 percent of 372 million is roughly 75 million. Let's say it is reasonable to assume that this decline is recognized through the income statement over the next two (2) to four (4) years.

So a 20 percent decline over -- over four (4) years means the Corporation has lost 108 million in expected investment income, plus another 75 million in recognized losses, for a total of 183 million over four (4) years, relative to budget. This is a very significant amount, an amount much larger than $100 million.

In light of this information, I'm not sure what to make of Professor Simpson's 100 million calculations. Because we have budgeted investment income, a 20 percent equity decline scenario is not simply half of a 40 percent equity decline scenario. So Professor Simpson's linear interpolation method is not appropriate in this case.

Also, to my knowledge, Professor Simpson has not considered the implications of his equity assumptions on the DCAT combined scenario, which includes both claim costs and equity variability.

As per page 25 of the amended DCAT, the corporation modelled an $87 million claims impact in the high loss ratio scenario. I do not believe that Professor Simpson has considered the possibility of including an adverse claims incurred impact, say fifty (50) to $60 million, in addition to the impact of an equity decline. Such a scenario would of course be subject to the plausibility rules of the DCAT.

Finally, a full DCAT review of this scenario would include the consideration of management and regulatory action. I did not see any assumptions presented by Professor Simpson in this regard. These assumptions are obviously very important, in terms of how the board responds to a $183 million loss.

I would strongly recommend that the Board does not consider, quote, "Rougher, back of the envelope," end quote, calculations for determining the appropriate RSR target.

MS. KATHY KALINOWSKY: Thank you. With respect to the evidence of Professor Simpson, he proposed a DCAT number of $100 million that would be appropriate, in light of the 81 million to $162 million target. He also to -- indicated that it might result in a surcharge if a particular adverse scenario occurred.

Can you explain how Professor Simpson's 20 percent decline in equities would impact upon policy holders if the proposed RSR target adopted was based on his $100 million DCAT?

MR. LUKE JOHNSTON: In a table on the following page, I put together a hypothetically scenario, assuming Professor Simpson's equity decline of 20 percent and a starting $100 million RSR target. The scenario was based on the following key assumptions:

Firstly, that other then equity variability, all forecasts will, on average, have no deviation to the budget over the four (4) year period.

Next, the 2012/'13 ending RSR balance is 100 million. This is effectively the Simpson recommendation.

Next, the four (4) year cumulative return on equities is negative 20 percent from 2013/'14 to 2016/'17. Again, this is from the Simpson evidence.

I've assumed the 20 percent equity decline occurs in thirt -- 2013/'14 and is fully realized in first two (2) fiscal years: two-thirds (2/3s) in the first year and one-third (1/3) in the second.

The equity returns in 2014/'15 and 2016/'17 are assumed to be zero percent, and this is such that the four (4) year cumulative return equals negative 20 percent.

The equity investment income assumed in

the table is per AI-9, which we've just gone through in the previous question.

I've assumed the Corporation would continue to forecast approximately, 6.1 percent equity returns throughout the forecast period, based on the long-term experience of equity returns. So even though we've had some poor years in the recent future, it hasn't impacted our -- our forecast of equity returns.

Finally, I've assumed that if the RSR is below the 100 million target, at the time of a given GRA hearing, the Board will order a surcharge to return the RSR to 100 million over the rate-setting period. I, of cler -- I, of course, do not know what the Board would do in this situation. But for this example, that's what I've assumed.

Moving to the table, you'll see the first fiscal year is listed as 2012/'13. And going across that row to the end, where it says, "Ending RSR balance," I've assumed that we start with $100 million, based on the Simpson evidence.

Moving to '13/'14, you'll see a stock return of negative 20 percent. This impact, if recognized, two-thirds (2/3s) in the first years is $50 million dollar loss. Moving over, we also lose about $24 million of budgeted equity investment income.

If you start at the 2013 -- '12/'13 ending balance, subtract $50 million lost from the 20 percent decline, plus 24 million loss in investment income, the RSR balance is down to 26 million, again assuming all other forecasts are on budget.

Under '13/'14 you'll note that the 2013/'14 rates would already be -- have been set under this scenario so I assume that there is no regulatory action possible.

Moving to '14/'15. Now we have a stock return of zero percent. We recognize the remaining portion of the 20 percent decline, which is 25 million. Again we lose our budget investment income because we have equity returns of zero. Moving along to the ending RSR balance, now we -- we had a beginning of year balance of 26 million. We've lost another 25 million in the recognition of equity gains and losses. We've lost our projected investment income of 26 million. We now have a negative RSR balance of $25 million.

Now under, "Regulatory Action," here I've made the assumption for this example that the Board would want to return the RSR to the $100 million target. To do this would require a 15.6 percent rate surcharge which would be needed to produce about $125 million in profits to bring the RSR back to the Simpson target of 100 million over the policy period.

Moving to '15/'16. Again we have a stock return of zero consistent with the negative twenty (20) over four (4) years. We've recognized all the equity losses at this point. The recognition of losses could have occurred at three (3) years or four (4) years. The final impact would be the same. Again we've lost investment income because we haven't earned any return on our equities.

In this column titled "Impact of Surcharges," you'll see that the rates surcharge, because of staggered renewals in four (4) -- in '15/'16 we would collect about half of that money. That's how I get 62.5 million.

So again starting with a negative 25 million RSR balance we again lose our equity budget of 28 million. We collect back some money through surcharges. However, our RSR is now only at 9.5 million. Out of the negative but still significantly below a hundred (100).

Again I've assumed regulatory action. This time in the order of 7.25 percent rate surcharge to produce 58 million in profits over the policy period to bring the RSR target back to the Simpson recommendation of 100 million.

A similar calculation in '16/'17. Again no equity returns. We lose our budgeted equity investment income. This time we have two (2) sur -- surcharges flowing through and being recognized. The 125 million, the second half of that gets recognized. We get half of the additional surcharge for an extra 91 million. We're now up to an RSR of 71 million.

Finally, '17/'18 I assume that our stock has -- returns are back at our forecast so we don't lose any investment income. We get the final portion of the rate surcharge. And we are back at the $100 million RSR. So obviously this is just an example but I hope it provides the Board with an illustration of how this might look.

Turning to the final page of -- of our evidence. This scenario generates over 22 percent in surcharges but Professor Simpson, quote, "wasn't troubled by it," end quote. What is troubling is that this scenario includes only a 20 percent equity decline. I presented evidence that, in my opinion, indicates that much larger equity declines are plausible at the one (1) in forty (40) year risk tolerance level.

There has been absolutely no evidence

presented to this Board that the $100 million RSR target proposed by Professor Simpson is suitable for protecting ratepayers. I'm recommending a minimum of $200 million in the 2012 DCAT report. The assumptions used in my DCAT analysis are, contrary to Professor Simpson's evidence, clearly laid out and transparent for the Board's consideration.

Based on the above example, if Professor Simpson believes that 1) we do in fact need an RSR, and 2) his own equity scenarios are valid, then he should be requesting a minimum RSR balance much higher than $100 million.

MS. KATHY KALINOWSKY: Thank you. Further expanding on Professor Simpson's suggested $100 million RSR, which does not include any losses to equity investment income, I note that in regards to the significant decline in equity returns that occurred in 2008/'09 and afterwards, Professor Simpson said, quote:

> "Over time, and it did, it rebuilt pretty fast once stocks recovered, at least my pension fund did."

End quote. Have MPI's equity recovered since 2008/'09, Mr. Johnston?

MR. LUKE JOHNSTON: As per the Corporation's response to Undertaking 16 and 17, page

2, I don't believe we need to go there, the Corporation's equity investment income has been $150 million under budget over the last four (4) years, including 33.6 million under budget in 2011 and '12. Those are corporate figures.

These results are not what I would call a recovery. I will also note that unlike Professor Simpson, the Corporation does not, in general, get to keep the equity returns from the good years to offset the bad years.

The Corporation expects that favourable equity returns will be rebated to policy holders to the extent that these -- this favourable experience increases the RSR balance significantly above the Board's target.

So in other words, if we have the opposite side of the equity risk, say a plus forty (40) favourable return, if our RSR balance is already sufficient when that happens it would be my expectation that all that additional monies would be rebated to policy holders because this would put us significantly over our -- our target.

In order for the Corporation to adequately protect these same ratepayers from significant downside equity risk, the Corporation requires an adequate RSR. Based on my evidence, I believe a DCAT-based RSR target of 200 million is required to protect ratepayers as per the stated purpose of the RSR.

MS. KATHY KALINOWSKY: Thank you for that, Mr. Johnston.

MS. CANDACE GRAMMOND: Mr. Chairman -- Mr. Chairman, what I would suggest at this stage is a short break in order that we can consult with Mr. Pelly, and Mr. Williams can consult with Dr. Simpson, and then there may be cross-examination for Mr. Johnston with -- with respect to the evidence that he's just given.

THE CHAIRPERSON: Okay. Let's do that. Would ten (10) minutes or -- ten (10) minutes be sufficient?

MS. CANDACE GRAMMOND: It should be.

THE CHAIRPERSON: Yes, let's do ten (10) minutes, please. So we'll resume at five (5) after 10:00 if that's sufficient.

MR. BYRON WILLIAMS: I would suggest it's probably more than sufficient. We will have some questions, but will probably require no more than five (5) minutes.

THE CHAIRPERSON: Okay. Let's break

for five (5) minutes and resume at 10:00.

--- Upon recessing at 9:55 a.m.
--- Upon resuming at 10:13 a.m.

THE CHAIRPERSON: I guess we're ready to resume. You have some questions?

MS. CANDACE GRAMMOND: Yes, thank you, Mr. Chairman. I just have a few questions for Mr. Johnston with respect to the evidence just given.

RE-CROSS-EXAMINATION BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Mr. Johnston, first question, I gather from your evidence and Exhibit 32 that the idea of a 20 percent equity decline was not run through the DCAT.

If that's right, can you tell us why it was not done that way?

MR. LUKE JOHNSTON: The -- sorry, the -- the DCAT does require a more elaborate process using the financial model. What I -- in -- in -- due to time I tried to prepare a -- as accurate as -- of a representation as I -- as I could. And in addition to that there -- there's also some assum -- assumptions that I have to make on my own.

Obviously the Board will decide if those assumptions are appropriate, but the impact that I've calculated in that example should be an order of magnitude relatively close to the actual impact based on the assumptions that I've listed.

MS. CANDACE GRAMMOND: And, Mr. Johnston, when you talk about the impact you're talking about the table that appears on the second-last page of the new exhibit?

(BRIEF PAUSE)

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

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Maybe I can -- I apologize. There is a -- one of the earlier questions talked about the 100 million calculation. And our understanding is that is in reference to the 20 percent decline.

What I tried to do, for the Board's information, is to go through very specific references in the app. For example, our equity investment income.

So it was fairly clear this -- these are the amounts that would be lost. And, again, it's not -- it's not run through a full DCAT, but those are our forecasts and approximate impacts.

MS. CANDACE GRAMMOND: So, just to be clear, Mr. Johnston, if you had the opportunity to run a 20 percent decline scenario through the DCAT, what do you think the target point would be -- the result would be?

MR. LUKE JOHNSTON: I -- I would expect that the impact relative to budget would be approximately the $183 million over four (4) years. As I stated in my evidence, there would need to be assumptions about management and regulatory action. And that was one of the reasons for providing the additional table, to show, in that particular case, given a starting RSR of 100 million, what types of regulatory action you might be looking at. So that -- that was the purpose of the -- the second table.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Okay. Thank you, Mr. Johnston. We'll -- we'll leave that point for the moment. Still looking at the illustrative table that you've provided on the second-last page of this new exhibit. You've built in, as you've described, a potential regulatory action that may be taken of a -- a 15.6 percent rate surcharge and a 7.25 percent rate surcharge.

When you created this illustrative table and -- and utilized those possible numbers, did you give consideration to the -- 'R' building -- or the rebuilding of the RSR that took place in the 1990s, that I understand was over a period of years with 1 or 2 percent increases?

MR. LUKE JOHNSTON: Not in -- not in this particular example. This -- it would be difficult for me to show, say, twenty (20) years of data here. Obviously, the Board could approach a regulatory action in -- in many different ways.

The -- the main point here, though, again is you do have an RSR at its low end of negative 25 million. And even with some very significant assumed regulatory action, it still takes you quite a while to get out of this predicament. Even after putting in the 15.6 percent rate surcharge, your -- your RSR is only back up to about 9 million.

If, say, a 1 or 2 percent rate surcharge would -- was put in, you can likely appreciate that

that would not have much of an impact at all to the -- the RSR balance, you know, in the following years. It would take many years to -- to get back to 100 million, assuming the Corporation didn't have favourable results from a -- a different aspect of its forecast.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Mr. Johnston, going back to my earlier question about what you thought the impact -- or, the result might be of a DCAT run with a 20 percent decline scenario, your answer was about 183 million.

I'm wondering about reconciling that with what we see in Undertaking 16 and 17, where there were a variety of scenarios run. On page 2 of that we have a scenario with a 36 percent decline that gives us a loss of about 169 million.

So we're just trying to understand how a 20 percent decline would give rise to a larger number than a 35 percent decline.

MR. LUKE JOHNSTON: Your -- your reference was page 2?

MS. CANDACE GRAMMOND: Yes, page 2.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: On page 1 --

THE CHAIRPERSON: Before you go there, could you -- could you refer to the exhibit number, please, so we can -- we --

MS. CANDACE GRAMMOND: I'm sorry, Mr. Chairman. It's MPI Exhibit 27. And it's the attachment that I referred to, not the body of the answer.

(BRIEF PAUSE)

THE CHAIRPERSON: Okay.

MR. LUKE JOHNSTON: On page 1 --

THE CHAIRPERSON: Hang on just one -- one second.

MR. LUKE JOHNSTON: Oh, sorry.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Are you there?

THE CHAIRPERSON: Yeah.

MR. LUKE JOHNSTON: On -- on the first page of -- not -- not the -- the text, but the first page of the tables, you'll see a scenario called "1" in -- under the title, "Four (4) Year Budgeted Compounded Returns Relative to the Fifth Percentile," you'll see a scenario that states:

"One 1:40 year event."

And the four (4) year cumulative return is negative 21.3 percent on the table. Can you see that? If you turn the page over, the equivalent result from that scenario is about halfway down the page, again titled, "Four (4) Year Budgeted Compounded Return Relative to the Fifth Percentile." That's the 1:40 year event there. And if you scroll across, you get about $186 million, approximately the same as the scenario we just discussed.

(BRIEF PAUSE)

CONTINUED BY MS. CANDACE GRAMMOND:

MS. CANDACE GRAMMOND: Mr. Johnston, the scenario in the DCAT was based on a one 1:20 year event, not a 1:40.

Do I have that right?

MR. LUKE JOHNSTON: The -- the DCAT scenario utilized the -- the full history of the TSX and then looked at the 5th percentile from that history and -- which was approximately negative 43 percent. And then we selected 40 percent as a -- negative 40 percent as a reasonable reflection of -- of a 1:20 to 1:40 year event. But that -- the -- the calculation we showed in -- in the DCAT was based on the 5th percentile, 1:20.

MS. CANDACE GRAMMOND: So should we not then be comparing it to the 1:20 year event on this exhibit? The one (1) -- the 170 million, or 169.5?

MR. LUKE JOHNSTON: Sorry, I should be more clear. The -- on the first page, the reason I pointed you to the -- the 1:40, negative twenty-one point three (21.3) was because that was the closest number to the negative 20 percent from Simpson. So I wanted to just direct you to an estimated impact that was about the same as Simpson's negative 20 percent calculation. And then again, flipping the page, you get the 186 million, which is very close to the one -- I believe it was eighty-three (83).

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Okay, thank you, Mr. Johnston. Another question with respect to the illustrative example and the new exhibit that we see on the second-last page, I understand that when you prepared this illustration, you assumed that all other things were equal.

And what I mean specifically is that you didn't take into account any increases in the bond portfolio, conversely to losses in the equity side.

Is that right?

MR. LUKE JOHNSTON: Yes, I assumed all impacts for all other forecasted items would net out to zero, which would be our expectation with break-even forecasting, best-estimate forecasting.

MS. CANDACE GRAMMOND: Thank you. Now you commented as well about the difference between the Corporation's budgeted investment income and equity losses, in the context of Mr. -- or Dr. Simpson's comment that his pension fund had recovered after losses.

Can you comment on whether the Corporation's position in that regard has been impacted at all by the rebates that have been ordered to be paid out over the last number of years?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Maybe I can -- just

ask if I have the question right. Is -- is your question: Given that we paid out significant rebates, we have less assets, and that results in -- in less investment income?

MS. CANDACE GRAMMOND: That's the question, is -- is the -- was the Corporation's ability to bounce back, if you will, affected by the rebates that have been paid out over the last number of years?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Hopefully I'm -- I understand the question correctly. The RSR recommendation through the DCAT would -- will be reflective of where we currently sit, in terms of our risk level. If -- if that means, in the case of rebates, that we've rebated significant amount of assets and that has brought down our equity balance, I would expect that the number out of the DCAT would be lower. Obviously, that's already reflected in our latest forecast. So the -- the forecast that we have in here do, of course, reflect the current level of equities.

In terms of the rebate affecting the Corporation's ability to bounce back, the Board did not rebate the RSR -- the RSR -- or sorry, the target RSR. So that was definitely still there for us to handle any potential equity declines that occurred in the future.

We -- we're just debating here that we believe that that number should be a little bit higher, based on the DCAT.

(BRIEF PAUSE)

MS. CANDACE GRAMMOND: Thank you, Mr. Chairman, those are my questions.

THE CHAIRPERSON: I have a few questions, if you don't mind, Mr. Johnston. And specifically, what I'd like to address is the assumption that you made that in the -- in a case of a 20 percent decline in the equity portfolio, there would be a total loss of investment income, which I think is part of the assumption.

And I guess my -- my view of that would be that it -- more likely that would be an equivalent decline in investment income. In other words, you wouldn't lose twenty (20) -- looking at the very first line of the table that talks about the impact of a four (4) year cumulative decline, you wouldn't lose 24 million; you'd lose, say -- say, 20 percent, maybe 35 percent of that 24 million.

So you're still getting an investment income of, say, eighteen (18), 17 million, which kind of negates some of the conclusions that you've arrived at, in terms of how quickly MPIC would be able to bounce back, because if you follow the assumptions here, you're suggesting that over the next four (4) year period there would be no investment income from the equity portfolio, which -- which, to me, seems to be a pretty extreme assumption.

Now, I -- I just want to hear what your thinking is about that.

MR. LUKE JOHNSTON: Well, the -- the difference between -- so on the one column here, we talk about loss of equity value. So the 20 percent decline not -- in this case is -- is impacting our current balance and -- and how we recognize the -- that loss of value over the next several years or multiple years results in approximately the same -- same impact once it's recognized.

The loss of investment income, however, is -- is simply our budget. And those -- those numbers flow through into our forecasts, which of course are included when we're asking for break-even rates.

If we have a four (4) year cumulative

return of zero, for example, we won't receive any of that investment income. So, for example, yeah, if -- if we start with an equity balance of 372 million and on average we earn zero percent over the next four (4) years, we'd still be at 372 million, and all that budget that we had for income will be gone. That -- that was the 108 million that -- that I spoke of.

So those are inner forecasts. We're expecting to -- that money to come in. Rates are set on the assumption that that money will come in. And when we don't receive it, it's just a straight loss to the bottom line.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Hope -- hopefully that was helpful in -- in answering the question. My earlier response, in terms of talking about how such a scenario would impact our bottom line, was essentially looking at all the different components and how we expected those to play out relative to budget -- so loss of value, loss of investment income, dividend income, et cetera.

MPI PANEL RESUMED:

MARILYN MCLAREN, Resumed

MS. MARILYN MCLAREN: Mr. Chairman, if I could speak just a little bit about the --

THE CHAIRPERSON: Certainly.

MS. MARILYN MCLAREN: -- history, what happened back in the '08/'09 time frame in that regard. We did still get some dividends from equity holdings, absolutely. But they -- the -- the net -- this is -- so the -- the year we talked about our -- our budget for investment income was about $100 million, and the actual was $4 million.

So -- but we actually did get some investment -- some equity investment dividends during that period, you know. The -- the Canadian banks didn't stop giving dividends. But what we did get in investment income was negated by having to recognize impaired investments.

We took a big hit from differences between a Canadian and US dollar back when the US investments were being hedged. Some equity stocks did stop the dividends.

So at the end of the day, the $24 million, as predicted, didn't completely disappear. A good portion of it came forward, but there were other big losses in investment income from equities that negated completely the expected 25 million. I don't know if that helps at all.

THE CHAIRPERSON: That's -- now, since -- since we are talking about assumptions, I -- I think that was -- for me, it was valuable to see the kind of sur -- surcharges that would be required to recoup investment losses of the scale that we've been talking about.

But, I guess, since we introduced the notion of -- of surcharges -- and this is a question, I think, for Ms. McLaren more so than Mr. Johnston. One of the regulatory actions that's available to MPIC, other than seeking a surcharge, would be to decide at the Board level that they would be using excess reserves on the other lines of business to -- to address a shortfall on the Basic side of the business.

Now, do you consider that to be a reasonable assumption?

MS. MARILYN MCLAREN: I would say that based on history, it's possible. That it -- we've talked about that here. That has been done in the past, where -- in order to build up the RSR, you know. And I think, if -- if the competitive lines of business were not negatively affected by the same kinds of things that were neg -- negatively affecting Basic, that that's a big "if", first of all.

But if -- if that was true, and if there was an opportunity to restore some stability in Basic without hurting the Extension lines, I suspect that it's something the Board of MPI would consider again, as -- as it has in the past. But -- but there's no guarantee that -- that the other lines wouldn't -- would not also be affected somewhat, and there's no guarantee if and when that happens there's excess in those lines either.

THE CHAIRPERSON: Based on -- based on what we've heard, though, the -- the likelihood is that the reserves on the other lines of business and on Basic lines of business would likely be impacted as well, right? I mean, when you -- when you blend your -- your investment portfolio you -- you sort of don't distinguish between what will be more -- more risky on the -- the reserve -- the Extension side, or...?

MS. MARILYN MCLAREN: Right. It -- it's one (1) investment fund that's then allocated by allocation policy. Yeah.

THE CHAIRPERSON: And I guess it kind of gets to the -- to one of the -- the dilemmas that I see in -- in the rate application right now. Because on the one hand, we're being asked to sort of reconsider the approach on the reserve side for Basic, based on the DCAT, which would mean an in -- an increase in reserves. And on the other hand, we're seeing excess reserves in the other two (2) sides of the business -- two (2) lines of business: the Extension and the SRE.

And so you understand the man in the street, or the woman in the street, saying, okay we're going to increase the reserves on the Basic side. And we have these excess reserves under the same roof for two (2) different lines of business. All of which is perceived by Manitobans to be the same fund, right?

So you can understand the dilemma that we face as a Board member to -- to explain to Manitobans why we would go along with this. Because I -- I've heard your argument regarding the -- this, you know, sort of -- the -- these are separate lines of business that should be considered separately, and I'll concede that that's a -- a reasonable approach to -- to do things.

But at the heart of this, though, is the -- is the notion that we should -- we should see the reserves for the Basic lines of business totally independently of what's going on on the other lines of business. And I'm struggling with that. And I -- I guess I'd like to hear your point of view about that.

MS. MARILYN MCLAREN: I -- I think, you know, given issues of -- from two (2) perspectives. Given issues of, you know, legislation and jurisdiction, I -- I believe this Board's role is to focus on Basic, for sure. And then I think also that it's critically important for all of us to think differently.

And I -- I believe that that's, in no small part, why the legislation is different about Basic is mandatory, compulsory. No choices here. And so we have to think about taking care of, protecting, manage -- managing prudently an insurance fund that people have no choice as to whether they're a part of.

Now, you know, if -- if we get in trouble on the competitive lines and have to do things with rates, and people decide not to buy it, and -- you know, I mean that -- that's a different story. They have that right.

So, I mean, I think first of all in terms of, you know, this Board's mandate, but -- but because of the reality is that this is a Basic compulsory program for which Manitobans have no choice to -- to spend their money. If you want to register a car, if you want to have a driver's licence, there's no decision to be made here. It has to be looked at on its own.

Now again you get -- you get to a situation where the Basic program is in dire straits, how could the Corporation's board of directors not consider every opportunity to help stabilize that. But just like I talked about why I would suggest to you that you pick a number based on the DCAT as the -- as the RSR target, decisions about what to do next are very situational.

So taken the next logical step, if this Board was to decide that well, you know, they think the DCAT is a good approach and they think probably the $200 million is a good number but they're going to rebate everything that the Basic fund has today that's in excess of one hundred (100) because they're going to assume that if something bad happens on Basic money will come from MPI's other -- other parts of the business.

I don't -- I don't think that's appropriate. I mean, I think you should probably look -- if the time comes when Basic is in dire straits, the other lines are not in dire straits and have some excess capital, you should look for some sort of partnership to help rebuild the RSR. I think that's reasonable. And to have -- and ask for reasons as to why that that's not possible if the Board decides it's not possible.

But when -- when at this point we're working so hard to continue the stability of Basic, to me, the logical conclusion is saying, Well, why would I keep money from Basic ratepayers when we think you also have money over there on the other side. That means you're thinking about rebating money because if things go bad you can go get it from somewhere else, or we can all go get it from somewhere -- I -- I don't think that's appropriate.

I think what do you do when you have to rebuild is a fair question that we all -- all have to think about. But we're not in that situation right now, and we're trying to think very -- as pragmatically and logically as we can about what is the process to decide. You know, what is the risk and -- and how to identify that. And then in -- in the future there are either decisions about when do you rebate, how do you rebuild, then they will be based on -- on those circumstances.

It's also not -- you know, I mean it looks for -- for reasonably small lines of business.

It does look like there is a fair bit of excess there. I mean, I think we talked about 100 million or -- or something along those lines.

But having said that as well, you know, remembering that just like for Basic we run the DCAT on those lines and we have a minimum retained earnings. And -- and if you talk to -- I'm sure if you talk to -- to Mr. Pelly, if you talk to other people in the insurance business, when they are running, you know, competitive lines of business, the minimum -- and in the regulatory framework in competitive lines of business the minimum is when the regulator steps in and starts taking action on your business.

So it's not all you ever need. It's the minimum. And if you look we -- there's some conversation about some other insurance companies. I -- I know there's publicly available information that I can't remember at the moment where to find, but there is information that's distributed about insurance companies and the extent to which their retained earnings exceed the targets.

Now mutuals in particular have many, many times more -- like five (5), six (6) times more their minimum target. We're certainly not in that ballpark at this point, you know. So I mean while there's more, at the most it is maybe $100 million from the very minimum you need.

So it's not like -- and -- and that's the difference with competitive lines, and that's why we have the conversations about sort of that regulatory framework and so on that I -- I don't think that it -- it's appropriate to sort of think in your minds about, well, what's the skinniest we can get by on Basic because until that money disappears over there, like it's probably coming over. You know?

I mean I think it has to be discrete enough, that you don't think about it in that context and that there's very different decisions to be made from what do you think is a methodology? What number are you comfortable coming out of that methodology?

Different decisions in the future about, okay now, do we rebate. And why exactly are we going to rebate? And if you have to rebuild, how quickly and how painfully, right?

THE CHAIRPERSON: There's no -- you know, there's no disputing, we would be having a bit of a philosophical argument here, but there's no disputing that the -- the PUB is invested in -- in insuring that we have a robust sound financially thriving public auto insurer.

I mean there's no question about that. And I'm not disputing that but I -- I think that what I see as being something that we need to communicate adequately, both at our level but also at the level of the board at MPIC, that, you know, why is it that we need -- why is that we're going to end up with 400 million in the -- in the reserves if PUB goes along with the rate application and what MPIC needs is 300 million to be -- to be --- so I think we need to do some explaining, I think, to rationalize would could ultimately be the situation we're in post this rate application.

I think we're heading into a -- we are in a -- already in a volatile environment, and I think that you conveyed that message. I think the parties, to me, have seemed to convey that message but I'd -- I'd like to hear what the other parties -- I'd like to hear what the other parties have to say about this particular topic, going forward.

I would suggest that before we talk to the other Intervenors, that we take a break of, say, 15 minutes, come back here at 11:00, if everybody's in agreement?

MR. BYRON WILLIAMS: Mr. Chairman, if we could, I do have a few questions for Mr. Johnston.

THE CHAIRPERSON: Okay, go ahead, please.

RE-CROSS-EXAMINATION BY MR. BYRON WILLIAMS:

MR. BYRON WILLIAMS: Mr. Johnston, we won't be long. Please keep at hand MPI Exhibit 32, handed out this morning. I want to direct your attention first of all to page 2, of MPI Exhibit 32, the table appearing --

Now, first of all Mr. Johnston, in terms of the table appearing at the top of MPI Exhibit 32, page 2 titled, "For Your Cumulative Returns," you'll agree with me that this is not a structural break analysis, sir?

MR. LUKE JOHNSTON: No, rather than selecting a particular point in time, I just hope to show a full spectrum of -- of time periods that could have been selected. I recognize the year 1956 was selected for a particular reason, but I just struggled comparing pre- and post-1956 because I didn't just pick pre-1956 and use that. I looked at the full history and perhaps there are arguments that could be made to use shorter periods of time.

When I pre -- prepared this table I found that, at least from a mean and standard deviation perspective, there wasn't huge differences in terms of what look-back period you selected.

MR. BYRON WILLIAMS: Mr. Johnston, just -- let's be clear first of all. You're agreeing with me that this is not a structural break analysis?

MR. LUKE JOHNSTON: Based on what I understand that to mean, no, I did not look for structural breaks, like -- like, for example, modern economic stabilization policies, I didn't do that.

MR. BYRON WILLIAMS: And you're aware as well, of course, that Professor Simpson's analysis at slide 7 was exactly that, a structural break analysis, sir?

MR. LUKE JOHNSTON: Yes, I believe I understand the rationale for his selection.

MR. BYRON WILLIAMS: And you've also confirmed previously of course, that you did not undertake such a structural break analysis in -- in analyzing this issue?

MR. LUKE JOHNSTON: That's correct, I looked at all the data. And as we did discuss, judgement was required in terms of how to consider some of those very significant declines, pre-1956.

MR. BYRON WILLIAMS: And let us take your table and just if -- if I were to look at the negative 2.5 percentile, sir, for any historical per -- period you examine, you'll agree with me that that will be comprised entirely of four (4) year cumulative returns ending in the Great Depression?

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Can you -- can you repeat the question?

MR. BYRON WILLIAMS: Sir, if I were to take the negative 2.5 percentile for any historical period examined, you'll agree with me that it will be dominated by negative -- negative cumulative four (4) year returns from the 1930s?

MR. LUKE JOHNSTON: I -- I guess I'm just maybe having trouble understanding. So if you took the 2.5 percentile --

MR. BYRON WILLIAMS: Sir, let me try again. If you took -- if you took the data points for any historical period examined from -- in your column on the left and you looked for the negative 2.5 percentile observation, the worst -- the worst observation, sir, you'll agree with me that that, for each of the periods examine -- examined, will be primarily comprised of data ending in the 1930s?

MR. LUKE JOHNSTON: I think -- I think I'm just struggling with the wording. But if -- if your question is that the large declines in excess of negative 40 percent cumulative returns occur prior to 1956, then I -- I agree.

MR. BYRON WILLIAMS: I'm going to take you further, sir, though. If I was going to look for the 1969 to present period -- actually, no, I'll ba -- I'll back up. I understand -- I understand your -- your answer, sir.

Sir, in terms of -- in terms of your re -- your next response, it is correct that you did not perform a DCAT analysis for the negative 20 percent cumulative four (4) year return?

MR. LUKE JOHNSTON: That's correct. I did not perform a full analysis.

MR. BYRON WILLIAMS: And if memory serves me right, sir, when you did a negative forty (40) year -- excuse me, 40 percent decline -- cumulative decline over a four (4) year period in your -- in your DCAT scenario, the decline in retained earnings at the 2014/'15 period was roughly 200 million, agreed?

MR. LUKE JOHNSTON: Agreed.

MR. BYRON WILLIAMS: And, sir, you'll

agree with me as well that when you did your decline in retained earning scenario for the PUB, in your response to PUB-2-32, at a negative 35 percent decline, the decline in -- in retained earnings for the 2014/'15 year at the start was 175 million, agreed?

MR. LUKE JOHNSTON: Subject to check, I agree.

MR. BYRON WILLIAMS: And so, sir, assuming that one were to undertake a negative 20 percent return analysis, you -- through your DCAT analysis, you're not in any way suggesting that that outcome would be greater than $170 million?

MR. LUKE JOHNSTON: That's right. The 40 percent decline, a 35 percent decline over a four (4) year period have a much significant -- more significant impacts than the 200 million and $175 million that were just referenced. Over a four (4) year period, those -- those impacts are larger.

For the 40 percent decline in the DCAT, we assumed management action after the second year. The -- the full -- these considerations, at least in Professor Simpson's table, I -- I didn't see particular assumptions on how to do this. What I have given the Board is ex -- examples showing what a 20 percent decline actually means for MPI Basic. And I've also shown hypothetical management and regulatory action.

So if -- if you are looking at, say, the second-last table in my evidence you'll -- excuse me -- you could see that the -- the ending RSR balance in that scenario is down to negative 25 million, which is only -- which is only -- only 125 million lower than the original target.

So what happens after that does require some -- some significant judgment. These are the types of regulatory actions that are possibility under this scenario. So clearly, there's a lower impact after two (2) years, but then at that point we have to decide how to act.

MR. BYRON WILLIAMS: Now, Mr. Johnston, just because the -- my question may have been lost in your answer you were not telling this Board that if you did an equivalent DCAT analysis, such as what you did in your DCAT decline in equity scenario or your response to PUB 2-32, that the result for the 2014/'15 period would be greater than $170 million?

Sir, restricting yourself to my question this time.

MR. LUKE JOHNSTON: Without knowing the full spectrum of assumptions used by Professor Simpson, I can -- all I can do --

MR. BYRON WILLIAMS: I'm asking about your analysis, sir. And I'm asking -- you're not going to tell us after doing a negative five (5) -- minus thirty-five (35) and saying it's thir -- 175 million in -- decline in the clai -- retained earnings, you're not going to say it's -- it's greater -- greater than that for a minus twenty (20) decline?

MR. LUKE JOHNSTON: Hopefully I can finish this time. The -- when I provided Undertaking 16 and 17, I hoped to provide the Board with the full impact of these various scenarios, which did not exclude -- or, pardon me, did not include management and/or regulatory action.

Professor Simpson's example does not state what he assumed in that regard, how the loss occurred, what would be done, how it impacted other DCAT scenarios. So you're right. I've no idea how this particular scenario would play out in the DCAT, because I don't know the assumptions that Professor Simpson is making.

If -- what I tried to do in the second-last page here is to show relatively similar assumptions to the DCAT, that being recognition of this decline in the first couple of years, loss of investment income. You see the RSR at negative 25 million. The Board can clearly see that that's not a $183 million decline. They can see that it's $125 million decline.

But again I don't -- at that point I have to assume some kind of management action in this example. I don't have that information. Professor Simpson -- all I can say is that over a four (4) year period, this is about $183 million impact. And it's very important to understand how we'd -- we'd react to that scenario through other -- other management and regulator actions.

MR. BYRON WILLIAMS: Sir, if one were to focus on the decline in retained earnings of the 2014/'15, and run a minus 20 percent scenario through the DCAT model that you employed in your decline in equities, the result would no doubt be less than $170 million.

MR. LUKE JOHNSTON: If all the exact same assumptions were used, that would be the case.

MR. BYRON WILLIAMS: And indeed, sir, the result, you would agree, would be no doubt less than $150 million.

(BRIEF PAUSE)

MR. LUKE JOHNSTON: Assuming the type of regulatory actions in the second-last table of my exhibit.

MR. BYRON WILLIAMS: Sir, just to make sure our questions are in agreement, if you -- we've agr -- if you were to run the 20 percentile figure through your DCAT model, looking for the 2014/'15 decline in retained earnings, you would agree, no doubt, that the -- that the decline would be less than $150 million?

MR. LUKE JOHNSTON: How about this? The decline in retained earnings, as of the end of '14/'15, would be less than $150 million.

MR. BYRON WILLIAMS: And indeed, sir, it would be less than $130 million?

MR. LUKE JOHNSTON: Based on the approximations in this exhibit that I've prepared, I -- I would say that's true.

MR. BYRON WILLIAMS: I have no further questions, Mr. Chairman.

THE CHAIRPERSON: Okay. I would suggest that we break for ten (10) minutes and resume at ten (10) after 11:00, according to that clock on the wall. Thank you.

(PANEL STANDS DOWN)

--- Upon recessing at 11:00 a.m.
--- Upon resuming at 11:11 a.m.

MS. KATHY KALINOWSKY: Sorry, if I could apologize for our president. She's actually giving an interview right now to the Winnipeg Free Press, not on the PUB General Rate Application, but on another matter. So if we could still proceed, unless there's questions for follow up. But if you're going into your closing comments, we can certainly proceed in her absence.

THE CHAIRPERSON: Thank you. Ms. Grammond...?

CLOSING SUBMISSIONS BY BOARD COUNSEL:

MS. CANDACE GRAMMOND: So we have now completed the evidentiary part of this hearing with respect to MPI's 2013/'14 General Rate Application. The Board will soon be deliberating upon the Application for base rates and premiums charged for compulsory vehicle and driver insurance to take effect March 1st of 2013.

As the lawyer for the Board, I don't

take a position on any of the requests made by MPI or the position taken by the parties. Rather, my role today is to summarize the issues that are before the Board and some of the evidence that has been given.

So as we know, MPI is seeking approval for rates that will constitute no overall change in premiums. The Corporation is also seeking to implement some changes for driver licence premiums on the demerit side of the DSR scale, which would bring the maximum driver premium to twenty-five hundred dollars ($2,500). The Corporation is not seeking any other changes in terms of service or transaction fees, certificate fees, and so on.

So the average rate adjustment proposed by MPI for each major class is as follows. For private passenger, no overall rate change. For the commercial class, a decrease of 5 percent. For the public class, an increase of 3.3 percent. For motorcycles, a decrease of 0.2 percent. For trailers, an increase of 6.3 percent. And for off-road vehicles, an increase of 14.3 percent.

So it's all of these adjustments taken together that lead to the overall proposed no rate change. If the proposal is accepted, actual ve -- vehicle premiums charged to motorists will vary, depending on claims experience, the driver -- the driving record of the registered owner, the insurance use territory, and vehicle rate group.

After consideration of insurance use and territory, the capping rules and balancing for experienced rate adjustments, the results were modelled by the Corporation to assess the impact of various rate and classification changes. In total, the vehicle population for next year, 2013/'14, is just over a million vehicles, which includes about fifty-seven thousand (57,000) off-road vehicles.

And so, if granted, the effect on the vehicle fleet would be as follows. About five hundred and sixty-five thousand (565,000) vehicles, or 55 percent of the fleet would have a rate increase, the majority of which would be twenty dollars ($20) or less. About four hundred and thirty thousand (430,000) vehicles, or 42 percent of the fleet, would get a rate decrease. And then about twenty-three thousand (23,000) vehicles would have no change.

Now, the Corporation has provided to the Board, as part of the filing, its updated financial results for the 2011/'12 financial year, as well as some current results for the year we're in, 2012/'13. And for the 2011/'12 fiscal year, we see their financial results at TI.11, which is Tab 9 of the Board's book of documents.

We see that MPI realized a net income in that year of about 18 1/2 million for rate setting, which was about one point four (1.4), 1.5 million -- or, sorry, about 2.6 million more than what they had forecasted last year. They were only, at that time, expecting about 16 million in income.

For the current year, 2012/'13, we have the results at TI.12, which is Tab 10 of the Board's book of documents.

Last year, MPI was forecasting, for the current year, a loss of about a million and a half. And that was after application of a transfer from the IT optimization fund of about 3.3 million. In this GRA, MPI is forecasting a $4.7 million loss for rating purposes and is no longer proposing a transfer from the IT optimization fund.

MPI's revised forecast for 2012/'13 reflects an increase in net premiums earned of 13 million, offset by a reduction in service fees and other revenue of 5.6 million. So the total earned revenues are forecasted to increase by 7.4 million over that forecasted last year.

The reduction in service fees and other

revenue that I spoke of was attributed to lower interest rates which reduced income from time payment plans and, as well, the reclassification of real estate investments under IFRS or, for the record, the International Financial Reporting Standards.

MPI's revised forecast for 2012/'13 also reflects an increase in total claims cost of 10 million. That's comprised of about a $2 million increase in net claims incurred and about a $7.1 million increase in claims expenses.

The forecast for operating expenses has decreased by about 2.4 million over that forecasted last year, while commissions and premium taxes are expected to be 2 million more than forecast last year. Overall, total expenses are forecasted to be about seven hundred and sixty-one thousand (761,000), so under a million less than at last year's GRA. Income investment is forecasted to be 2 million more than was forecasted last year.

Now we have on the record MPI's second-quarter report for the current year. So that's as of August 31st, 2012, and that's been filed as MPI Exhibit 30. In that second-quarter report, we see that MPI recorded corporate net income of 21.2 million for the first six (6) months of this fiscal year. That's compared with 34.2 million during the same period next year, so about 13 million less. And of that corporate income of 21.2 million, about 5 million is attributable to Basic, which is compared to 13.6 million to Basic for the same six (6) months last year.

The revised forecast for 2012/'13 reflects a net loss of approximately 8.4 million to the Corporation as a whole. And MPI advises there is no change in the forecasted loss for Basic of 4.7 million for the current year.

MPI's forecast for the year of the application are found at TI.13, which is Tab 11 of the book of documents. And its projections for the outlook period, from 2013/'14 through 2016/'17, are reflected at TI.15(a), which is found in Tab 13 in the book of documents.

MPI has advised that it seeks to break even over a two (2) year period. It's projecting a $5.6 million loss for the year of the application and net income of 8.3 million in 2014/'15. MPI is also forecasting growth in its income over the outlook period, which is due to the volume factor and the upgrade factor, as well as increased driver premiums arising from the DSR scale.

With respect to the Rate Stabilization

Reserve, or what we call the RSR, the Corporation has confirmed this year, again, the stated purpose, which is to protect motorists from rate increases made necessary but unexpected events or losses arising from non-recurring events or factors.

According to the basic financial statement, which we find at AI-7 of the filing in volume 3, total Basic retained earnings were 213.7 million as at February 2012, and that's after an RSR premium rebate of 14.1 million. With AOCI, or accumulated other comprehensive income, total equity in basic was 262.7 million as at year end of 2012.

Total Basic retained earnings are forecast to be 205.3 million at the 2012/'13 year end and 199.7 million at the 2013/'14 year end. And both of those forecasts exclude AOCI.

The Board has ordered previously -- or, had ordered previously that MPI file an updated DCAT or Dynamic Capital Adequacy Testing; an MCT, Minimum Capital Test; and RA/VaR, which is the Risk Analysis/Value at Risk, at this year's hearing in order that the methodology for setting the RSR target could be reviewed.

At present, the methodology by which the RSR is set is on the basis of 10 to 20 percent of gross written premium. The existing RSR range is between 75.6 million to 151.1 million, and that is forecasted to grow to 79.9 to 159.7 million in 2013/'14 if the same methodology is used.

MPI has provided an analysis on the pros and cons of each of the four (4) approaches that have been used or considered in setting the RSR target range, and has recommended that the Board accept the DCAT, suggesting that the DCAT approach is superior to the other methods as it analyzes and assesses all of the key financial risks faced by MPI.

Based on the risk assessment done by MPI, a series of adverse but plausible scenarios were developed for each key risk factor, or combination of risk factors. And the evidence of MPI is that in order for the scenarios to be considered plausible by the actuary the scenarios must have a 1 percent to 5 percent probability of occurrence. The adverse scenarios must also be plausible in that reasonable management and regulatory actions must be taken into account.

The DCAT that we have in evidence before the Board was prepared internally by MPI's actuary and witness, Luke Johnston, based on the Canadian Institute of Actuary Standards, and in a -- in accordance with accepted actuarial practice.

The DCAT states that the Corporation's financial condition is satisfactory if throughout the forecast period it is able to meet all of its future obligations under all plausible adverse scenarios, and under the base scenario that meets the minimum regulatory capital requirement.

Based on this definition, Mr. Johnston has concluded that Basic's future financial condition was not satisfactory at the current approved regulatory maximum RSR target level. Based on the result of the DCAT analysis, and in particular the decline in equity market scenario, the Corporation has determined and is seeking a $200 million RSR level.

The decline in equity market scenario is the most significant of the tested adverse scenarios. This scenario tested the impact of a 40 percent decline in equity returns recognized over a two (2) year fiscal period commencing in 2013/'14 and 2014/'15, and continuing for four (4) years.

In justifying the scenario, MPI looked at the cumulative four (4) year returns of the Toronto Stock Exchange from 1919 to present and found that 5 percent of these four (4) year returns reflected a loss of 43 percent or worse.

The Board heard evidence from CAC's witness, Dr. Simpson, who spoke about the balance between providing sufficient reserves to stabilize rates from unforseen nonrecurring events versus the opportunity costs of holding an RSR balance that is not paid back to ratepayers who, if they had the money in hand, could use it for other purposes.

Dr. Simpson also questioned the appropriateness of the use of pre-1956 stock exchange data in the decline in equity market scenario. Dr. Simpson testified that in his view there was a structural break in the four (4) year loss returns in the pre- and post-1956 data, noting that the standard deviation of returns from 1923 to 1956 was point five six (.56), while the standard deviation of returns from 1956 to 2012 is almost half of that at point three one (.31).

And for the record that evidence was given at page 1,427 of the transcript. Dr. Simpson recommended that the data from 1919 to 1955 be excluded from the DCAT analysis as it does not reflect the modern era.

Dr. Simpson has calculated a lower target RSR level based on post-1956 data, noting that the combined four (4) year decline post-1956 had not fallen below a negative 16 percent. Dr. Simpson based his reserve calculation on a 20 percent decline in equity markets. He did not provide a DCAT analysis to support his lower reserve amount.

What is not certain is whether another adverse scenario becomes -- what is not certain is whether another adverse scenario becomes the dominant determinant of the target RSR level if the equity decline scenario becomes less significant. And of course we've had some additional evidence just this morning from Mr. Johnston in response to Dr. Simpson's evidence.

Dr. Simpson expressed the view that the DCAT results should be carefully considered in the future regarding the determination of the RSR target as the DCAT is inextricably linked to the MCT. Dr. Simpson recommended that the MCT ratio associated with any adverse scenario should be calculated and reported.

In addition, Dr. Simpson called for transparency, evidence-based justification of adverse scenarios, and stability as the three (3) aspects of the DCAT that are needed in order for the DCAT to assist in setting the RSR target level.

Dr. Simpson also suggested that a consensual process involving the Board and Intervenors and MPI be adopted for an assessment of the DCAT analysis and the adverse scenarios to be chosen. Dr. Simpson proposed that a separate process should be undertaken to gain an understanding of the DCAT model to provide more transparency in the -- in the modelling and assumptions, pending which the existing percentage of premium approach should be maintained.

Dr. Simpson also re -- recommended in his report that the DCAT MCT analysis as it evolves and improves should be an important but not the sole indicator of the RSR target.

MPI's external appointed actuary, Mr. Cheng, has also made a number of suggestions to refine the modelling assumptions for several of the DCAT scenarios. These are, of course, reflected in the peer-review report filed as an exhibit. We of course have not heard oral evidence from Mr. Cheng directly, but the Board has heard evidence at this hearing and in the past regarding whether the Board should consider AOCI in accessing the adequacy of the RSR.

In particular, the Board now has Mr. Cheng's report wherein he supports the inclusion of AOCI in the threshold stating, quote:

"I believe the threshold for failing this test should include monies available under accumulated other comprehensive income section of total equity, not just the RSR."

And that evidence is referenced in -- at page 1,365 of the transcript through Mr. Johnston. MPI has stated that AOCI should be a consideration when deciding on rebates and surcharges if there is a very significant or a very negative AOCI balance.

MPI has further stated that the DCAT takes into account the actual recognition of losses and allows for some recovery from a stock market crash. If there were a significant single-year impact the Corporation would substain (sic) substantial unrealized losses in its equity portfolio in a given year.

Mr. Johnston has expressed the opinion that the Board would not be expected to immediately issue a surcharge without seeing the recovery or realization of losses. And that's at the transcript page 1,366.

In establishing Basic rates the Board has stated in the past that it looks to the overall financial wellness of the Corporation. MPI has expressed some disagreement with this approach and has asked that the Board look at Basic's retained earnings on a standalone basis, as it is a mandatory line of business that has to stand on its own financially, though MPI acknowledges that the Basic Compulsory program is the vast majority of the Corporation's operation.

The Corporation has, as of the year end 2011/'12, 431.6 million in retained earnings, which includes 213.7 million in Basic, 97.9 million in Extension, 20.8 million in the Extension Development Fund, 45.8 million in the Special Risk Extension line of business, and 58.1 million in AOCI.

MPI has exceeded its retained earning targets by over 100 million and has not yet advised of a strategy to deal with the excess retained earnings. Last year the Board heard evidence from the Corporation with respect to a proposed IT optimization plan and related fund.

This year MPI presented an alternative, having entered into an outsourcing contract with IBM to manage MPI's data. As a result, there will be a reduction in capital costs from that proposed last year down to 45 million from 75 million.

MPI has approved a total of 99.4 million in spending on this project, including 12.9 million for data transition and migration, and has advised that about twenty (20) EFTs, or equivalent full-time positions, would become redundant as a result of the outsourcing arrangement, though that would not equate to staff layoffs as staff will be reassigned within the Corporation.

Also, a matter of evidence in this hearing has been the Corporation's cost allocation methodology, which is necessary to have, because MPI has shared global corporate costs that must be allocated among its lines of business in a way that does not give rise to cross-subsidization.

MPI had engaged Deloitte a couple of years ago to undertake a cost allocation methodology study. In previous years this Board has endorsed the methodology, but did not approve its use for rate-setting purposes.

MPI has implemented the new methodology for financial reporting purposes and is util -- utilizing the previous cost allocation methodology for rate-setting purposes, in essence, maintaining two (2) sets of books.

MPI had engaged KPMG to undertake specific procedures and test whether the methodology had been appropriately implemented in the 2011/'12 Basic financial statements, the result of which was that KPMG took no issue with how the cost allocation methodology had been applied.

MPI also advised that it thought it would be prudent to review the key allocators developed to assist in its assessment of ongoing reliability to produce a fair and reasonable outcome.

MPI engaged Deloitte to undertake an expense allocator review to evaluate the stability of the allocators used in its proposed cost allocation methodology.

For each of the allocators included in the scope of review, Deloitte prepared a four (4) year comparative analysis, revised the underlying allocator calculation, and provide ob -- provided observations and recommendations regarding their future determination.

Deloitte found the allocators used to be, for the most part, stable, but recommended averaging to be implemented for greater stability. And, as well, Deloitte has recommended the use of net claims incurred as an allocator over gross written premiums. This was proposed by Deloitte in previous GRA proceedings.

At the 2011 GRA, the witness from Deloitte, Richard Olfert, advised the Board that the gross written premiums approach was not improper, though Deloitte did recommend net claims incurred as the better allocator.

With respect to claims valuation, it is certainly the case that MPI's valuation of policy liability serves as the groundwork for the financial forecast used in the GRA. MPI has experienced successive material claims forecast reductions related to the valuation of the PIPP, or Personal Injury Protection Plan, unpaid claims liability through successive incurred but not recorded adjustments, which have totalled about 625 million over the last five (5) fiscal years.

MPI makes many assumptions in developing its valuation of liabilities, including a provision for adverse deviation which includes three (3) components. Firstly, a claims development margin. Secondly, the re-insurance recovery margin, and thirdly the interest rate margin. MPI has not made a change in the claims development margin from that used last year.

MPI has, however, increased the interest rate margin this year by twenty-five (25) basis points to a hundred and twenty-five (125) basis points, versus a hundred used last year. This provision was based on all coverages of the Corporation, the majority of which are indexed to inflation. This change in assumption resulted in an increase in claims liabilities by approximately $34 million.

MPI has indicated that due to the long time frame for the settlement of PIPP claims, there is more risk related to interest rate impacts. This risk is mitigated to some extent by MPI's fairly strong asset base, supporting the claims liabilities with a fairly low risk of default. The increase in the interest rate margin was to account for higher observed inflation rates, coupled with lower trending interest rates.

Now, we know that the Corporation's investment income is a major component of its income and offsets its annual underwriting losses. MPI's evidence is that the Department of Finance has ultimate authority over MPI's investments, although there is a joint investment committee working group in which MPI participates together with members from the Department of Finance.

The Board sought further evidence on this issue from the Assistant Deputy Minister to the Department of Finance, who was unable to testify at this hearing for medical reasons. The evidence reflects that MPI's investment portfolio exceeded $2.2 billion as at February 28th, 2012, and that the funds available for investment are primarily unearmed -- unearned premium reserves and unpaid claims reserves.

The investment portfolio support -- supports both the payment of accident claims as well as the pension obligations of the Corporation. MPI is projecting investment income of approximately 103.7 million for 2013/'14, of which 88.2 million, or about 85 percent, is Basic's share.

MPI's investment portfolio has a significant weighting in long-term bonds of over 64 percent. The bonds on the -- the returns on the bond portfolio are susceptible to changes in interest rates. Current average yields on the long-term bonds are below 3 percent. An increase in interest rates would result in a reduction in the value of the bond portfolio, and would negatively im -- impact returns.

MPI has advised that it utilizes an asset liability matching program to duration match the portfolio returns with the payment of its obligations, attempting to match the approximate average cash flow of assets to liabilities. Any changes in interest rates affecting the bond por -- the value of the bond portfolio will be 80 to 90 percent mitigated due to offsetting changes to the claims liabilities.

The size of the corporate investment

portfolio for the year of the application, 2013/'14, is projected to be over 2 1/2 billion, comprised of 64 percent in long-term bonds, 19 percent in equities, 2.5 percent in cash and short-term investments, 11.5 percent in real estate, .3 percent in venture capital, and 2.2 percent in infrastructure. The Corporation's investment portfolio is expected to grow to 2.9 billion by 2015/'16.

In 2011/'12, the Corporation wrote down impaired investments totalling 13.6 million based on IFRS requirements.

I also have some comments about capital expenditures. MPI has provided a corporate-wide capital expenditure forecast. The budget for 2012/'13 as presented at this GRA is 52.2 million, which will be spent primarily on IT optimization and disaster recovery projects. MPI is forecasting to spend 39.5 million in 2013/'14, and 32.9 million in 2014/'15 on capital expenditures.

In addition, MPI has made provisions for fut -- for future of service, physical damage, and road safety of 8 million in each of 2013/'14 and 2014/'15. MPI has continued its practice of providing a general provision placeholder of 20 million for future development projects for its budget in each of 2013/'14 and '14/'15. MPI has not yet identified specific initiatives with respect to those placeholders.

With respect to expenses, total Basic expenses were 187.3 million in 2011/'12, up from 170.6 million in 2010/'11, and are forecast to be 192.6 million in 2012/'13. Thereafter, Basic expen -- expenses are forecasted to grow to 194.9 million in the year of the application.

A major component of Basic expense are operating expenses, which are forecast to be 61.8 million in the current year and 63.2 million in the year of the application.

The increases in operating expenses that we have seen are partly attributable to higher amortization costs from improvement initiatives, which increased from 5.3 million in 2010/'11 to over 8 million in 2012/'13. In addition, data processing costs are forecast to increase from 12.7 million in 2011/'12 to 19.3 million in 2012/'13, which relate to the new IBM outsourcing arrangement.

Salaries and benefits are a major component of the operating expenses of the Corporation, representing over 55 percent of the total operating expenses in the year of the application. From 20 -- or 2008, so 2008/'09 to 2011/'12 the compensation expenses of the Corporation have increased by over 30 percent.

MPI is now forecasting a reduction in compensation expenses of 2.4 percent from 2011/'12 to 2012/'13, followed by increases of 1.7 percent in 2013/'14 and 1.3 percent in 2014/'15, both below forecasted inflation of 2 percent.

MPI's forecasts are based on an assumed zero percent economic increase in both 2013/'14 and 2014/'15, subject of course to negotiations with MGEU, the Manitoba Government Employees Union, which represents approximately 90 percent of MPI's employees. Negotiations with MGEU are ongoing and MPI has advised that the wage freeze would extend to both union and non-union employees.

In addition, MPI's staffing levels have increased since 2000. Prior to the merger with DVL, MPI had thirteen-hundred and sixty-four (1,364) full-time equivalents. And with the DVL merger the staffing levels increased to about seventeen hundred (1,700). Staffing levels thereafter increased to about nineteen hundred and forty-six (1,946) in 2009/'10. And after dipping down to around eighteen hundred and seventy-five (1,875) in 2010 and 2011, are expected to increase to nineteen hundred and seventy-one (1,971) in the current year.

Now we've also heard evidence at this hearing with respect to matters of road safety. MPI is forecasting to spend 11.4 million in Basic road safety and loss prevention programs on an annual basis in 2012/'13, and 10.2 million in 2013/'14. And the source for that is CAC/MPI-1-3 attachment.

Within the 2012/'13 Basic road safety and loss prevention program budget, the largest components are spending on the driver education and improvement program of approximately 3.7 million, and auto crime prevention strategies of approximately 4.3 million. The balance of the other programs relate to impaired driving, speed management, occupant safety, and other. MPI is budgeting to spend about seventy-four thousand (74,000) on motorcycle safety education.

In Board Order 122/'10 this Board recommended that the Corporation establish a road safety fund out of the RSR to be used for enhanced and new road safety research and initiatives. The Corporation has expressed the view that the fund would be particularly appropriate where there are identified initiatives that have an expected measurable impact on claims costs or that have a specific, defined objective.

MPI has stated that many road safety

initiatives do not have a clear payback, although there may be consensus that the initiatives are worthwhile. In that case, it may be better to build the cost of the initiative into revenue requirement so that the initiatives are sustainable.

The Corporation has recently had involvement in a consultative process and has indicated its commitment to work with stakeholders and consult with government to establish a clear road-safety role and mandate. One area that the Corporation is exploring is infrastructure investments or infrastructure funding that will improve road safety. And as well, they are looking at changes to driver education.

MPI has advises that it will be hiring a consultant to work with the Corporation in each of those areas, including with respect to infrastructure. They will be seeking the assist -- or, assistance in the development of recommendations for the program's focus, as well as a business case.

Part and parcel of road safety issues are claims that involve collisions with wildlife. MPI's annual exposure to wildlife claims is approximately 30 million. In response to a recommendation made by the Board, in October of 2011, MPI launched a joint study with the City of Winnipeg and the Winnipeg Police Service, aimed at reducing wildlife collisions in two (2) targeted areas within the City of Winnipeg that account together for approximately 25 percent of all wildlife collisions within the city limits.

The study involved the use of highly visible, variable message displays, increased public awareness, including targeted mail drops to all residential households in the study areas, and enhanced speed enforcement during the dawn and dusk periods, when wildlife are most active. The study ran for approximately two (2) months, until December 2011.

Overall, deer/vehicle collisions were 15 percent lower in October and November 2011 over the two (2) study sites compared to the average number of collisions over the 2006 to 2009 time period. MPI found that the actual claims cost savings were marginal relative to the cost of the pilot. MPI has not yet proposed any new initiatives to address wildlife claims.

In conclusion Mr. Chairman, members of the Board, I've attempted to comment on the main issues that arose this year. There are certainly other issues I'm sure that I have not commented on. I would like to thank the Board, the Intervenors, and MPI for their cooperation extended over the last number of days. If the Board has any questions for me, otherwise, those are my comments.

THE CHAIRPERSON: There are no questions from the panel. I'm looking a -- at the clock. I think we have time to hear from some of the other parties. So, Ms. Peters, I believe you're the next one that's up.

CLOSING SUBMISSIONS BY CAA:

MS. LIZ PETERS: Thank you, Mr. Chairman, and Board members and counsel, Ms. McLaren, and the MPI panel. Fellow Intervenors, thank you very much for this opportunity, once again, for CAA Manitoba to sit in this process. I always say this every year but this is our eighteenth year now, sitting as a -- an Intervenor in the process, and we -- we're very eager to continue our participation.

Even though it's just a watching brief, it remains our intent to -- to put ourselves and our organization in a -- in a position to be able to advocate on ver -- a variety of issues, like road safety, the lowest rates possible coupled with the highest quality insurance possible, and then just ad --

advocating for more transparency overall in the rate-making process.

Our presence allows us to communicate about what we see and hear to our membership of two hundred thousand (200,000), but also to the general public in Manitoba.

So this year, we -- we do support the Corporation's application for no change to vehicle premium discounts, but there are three (3) main topics that we'll comment on this morning, those being: the rate stabilization reverse and the possibility of a rebate, a cost allocation between the various lines of business, and various road safety initiatives and how they're paid for.

So in regards to the RSR, the very first question that I always ask myself when I come and listen in these hearings that I think needs to be clarified, maybe just for our purposes, but: What is the purpose of the RSR? Is it being used for the right reasons? Is it being used to fund projects that don't fall under the -- the jurisdiction that it should be used for? Or should it really just be used for emergency situations, unforseen events that may cause rates to rise by unacceptable amounts?

So, like I said, the question seems to

come up every year. CAA believes that the true intent of the RSR does need to be clarified. We believe that it was created for a specific purpose, as was stated this morning, and that's to tho -- the ratepayers from unforseen events. Should be used for only these purposes.

The other question that has come up, in my view, from these proceedings is: Is the RSR actually even necessary at all any more? Especially since the really -- the true purpose that it was intended for has only been used once or twice since it was established.

But despite that point, CAA very strongly believes that, yes, the Corporation does need to maintain an RSR, not only to ensure Manitobans are protected from rate shock in the event of one of these unforeseen events, but just even to give ratepayers the reassurance that they are protected if an event is to take place.

So after observing the last several weeks of testimony and cross-examination, CAA Manitoba believes that there should be a rebate this year. That would bring the RSR in line with previous Board expectations for the limit of this reserve.

Last year at these hearings, CAA

Manitoba raised questions about the -- all Intervenors by the -- raised questions about the DCAT methodology, even though there was not time to put it to the test during those proceedings. This year, a lot more analysis was done. But I think there still are questions, even just even today with testimony with that methodology and how it brings us to an RSR level.

The reserve levels required by the various methods, in our opinion, are -- are quite far apart. And we can't really endorse one over the other at this point. But especially after hearing Professor Simpson's testimony and some of the examination today, we would advise that the -- the current RSR limits that have been set out by the Board are the ones that are maintained for this Application.

So that said, it seems that an acceptable rebate would begin somewhere around $50 million. But I note that some other Intervenors have other opinions about how much money should be returned into the pockets of ratepayers.

Just a comment: Depending on what the Board decides with the rebate methodology, CAA Manitoba has generally said that a cheque should be issued, rather than just issued electronically on a, you know, rebated -- on the invoice rather than actually mailed out. We do think it's an important thing to maintain credibility so that people know that there is a process in place. And when they see that cheque in their hand, they know that -- that process has been served and that -- that we've gone through the due diligen -- due diligence of making sure that it has been.

Just one comment on the cost allocation methodology. It should -- it really just continues to be a concern from CAA Manitoba. I won't go into much detail, but really the bottom line is we don't think there's enough transparency in that process. Just from goings on in the last couple of years, we don't think that -- it hasn't satisfied us in that respect. That's all I really have to say about that one.

And the third -- the third topic near and dear to our heart at CAA is just we're always really interested to hear about some of the road safety initiatives that are going on, whether at the Corporation or -- or just through talking to members and the general public. So I'll provide a couple of comments.

First, on the driver education initiatives, we definitely want to commend the Corporation for endeavouring to improve that program. The high school driver education program has been, in our view, one of the -- one of the best things that the Corporation does for drivers in this province. It teaches them good habits from the beginning, which we always think is a good thing.

Another point on that was the accessibility of the program. I understand that students pay about fifty dollars ($50) to take that course, and MPI provides significant subsidization to make sure that it's accessible and affordable for students.

And while we're pleased that MPI continue -- or, plans to develop a new and world-renowned program, we definitely want to emphasize that we think a new program should be subsidized in a similar way so that it continues to be affordable and continues to be accessible for all students, just so that they're -- they're all learning the same rules right from the beginning and they're setting themselves on a -- on a good path to be good, safe drivers for their entire lives.

And Ms. McLaren acknowledged during her testimony that the new program would be -- would be different because of the way -- the world we live in now and the way we communicate has changed a lot. And we know that young people are among the most savvy, in terms of electronic devices and -- and whatnot. So hopefully the new program would take a lot of that into account.

I just wanted to recount a -- kind of like, CAA across Canada, different jurisdictions have different jur -- different programs, and a lot of our other clubs actually run the driver training program for high school students in their provinces. They have a lot of unique things that they do. CAA Quebec, for example, they purchased a state of the art driving simulator that they tour around the province for the entire year. Every single day, it's being used. It teaches things liked impaired driving, drunk driving, and actually simulates in a safe environment.

So that's just one example, and I think that it's something that has been very well received. So I would encourage MPI, through their consultation, be looking at other stakeholders in different provinces, different countries, to be seeing best practices and what we can learn from that.

And obviously, I think this is a point that's already been made, but we definitely encourage the consultation progress -- process for that to -- to include consultation with stakeholders like CAA. And we hope that that consultation also does look at the prospect that the program could be completely outsourced. If -- if it's found that maybe there's a third party that could implement that program, not necessarily just at a lower cost but more efficiently and -- and MPI could just administrate it, then they should at least consider that.

When it comes to points on a driver's licence, one thing that CAA in Canada -- 6 million members have told us that they think distracted driving with electronic devices is the number 1 road safety issue in their concern -- in their -- in their opinion.

So when people ask about how it's going in Manitoba, we've had two (2) years now since that new legislation brought in by the government has been in place, and CAA does surveys every year of our membership. It's not scientific, but we do have quite a substantial membership. So when fifty-six hundred (5,600) of our members tell us that 82.6 precent of them believe that they'll never get caught by police if they're talking on their cell phone when driving, it concerns us.

It's not something that can be changed overnight, and the police can't be everywhere all at the same time. But we definitely think that with this one in particular -- and I know it's not something that

MPI can change themselves, but the deterrent is not significant enough to make people be safe and put down the phone and not engage in these kinds of risky behaviours behind the wheel.

So CAA has already made it clear to the provincial government that we believe that points should be added to this legislation if they need to change the regulation or whatnot. But other provinces -- BC you get three (3) points on your licence when you -- when you're caught with this -- breaking this law.

So we think that that's something that needs to be changed, and we'll be lobbying the government. And we'll keep mentioning it here just for the record so that people know that we think that needs to be changed a lot more -- it needs to be a lot more strict.

With recent events on the roads involving older drivers, the debate has once again been raised in the public domain. Should drivers of a certain age be required to be retested to ensure they're competent and safe behind the wheel? CAA Manitoba believes that there is a need for some required retraining or retesting under certain circumstances, but those circumstances shouldn't be tied to a driver's record, not -- or, should be tied to a driver's record, not to their age. If a driver's had several accidents, several speeding tickets, that should be the trigger.

One program in particular I just wanted to highlight that I think MPI does a very good job, and it's a partnership they have with an organization called Safety Services Manitoba. And we've actually -- at CAA we've actually started using this program, encouraging our members to take this program.

We hold -- we employ Safety Services, which is funded by MPI, to come in and talk to our members about mature driving. And they go through a three (3) hour course that's completely free for anybody who wants to take it. That's just one (1) example of ways that we can encourage older drivers to voluntarily and proactively check how they're driving.

And it has nothing to do with figuring out if they're worthy to be behind the wheel or not. It's just a chance for them to find out how they're doing. So there are opportunities for older drivers, we think, that are already in place via the Corporation to -- to improve their skills.

And just on that note, with partnerships, I -- we say it every year, but we definitely think the Corporation should continue to look for -- look for opportunities to work with stakeholders. We already work with MPI on some initiatives, but there's always other opportunities we think should always be capitalized on, and especially like organizations like CAA. We're already in the public eye on the same issues as MPI, and we can really be an asset to -- when you work together, you can always accomplish a lot more.

Infrastructure spending. When it comes to the opportunity for MPI to fund specific infrastructure projects that could translate into fewer claims incurred and costs, CAA Manitoba has many questions about this possibility. While we acknowledge a similar endeavour has been successful for ICBC, we disagree that this is a strategy that Manitobans would likely support.

It goes without saying that a number of people will feel like they're paying twice from two (2) different pots. A lot of people, rightly or wrongly, feel that MPI is just an offshoot of the government, so there's some perceptions there that we would definitely be dealing with that would make people think that -- that they're paying through their rates and then they're paying through their taxes.

So that just -- that just concerns us,

and that's why we raise this point. And I know that it's just in the beginning consultation process right now, but we'll wait to pass judgment on the value of this program until after the consultant has been hired and had time to produce recommendations.

But as it stands right now, we definitely believe that infrastructure is the role of the government and should remain that way.

Two (2) suggestions, just knowing that the consultation process is moving forward, Ms. McLaren indicated that MPI hasn't yet consulted widely with municipalities. I -- we think that's a large part of the process moving forward, not only to ensure the municipalities are on board with the plan, but also so that if they are on board with the plan then they'll help communicate why this would be a valuable tool for the -- the Corporation to endeavour.

And then also, again, I know consultation has already taken place on a general level through the road safety vision process last year with the Corporation, but I would encourage them to once again come back to Intervenors and talk as the consultation is taking place to do a little bit more consulting with interested parties.

And then the last point I thought was

worth a mention was just -- just because CAA comes and does a watching brief at these hearings and our membership, not a lot of calls come in and people asking for information about the hearings, but I think that's just because they don't know what goes on here. But we've been here for eighteen (18) years and every single year when I leave these hearings I make an effort to communicate to our membership about what's happened, about what we've heard, about what we've seen, about -- about what the decision of the Board is.

It's just information that whether they realize they need to know or not, we think it's important. So I just wanted to make the point that we think it's a very important -- it's important to have transparency. And it just -- it reassures, I think, our membership that the process is being followed. And we tell them about the lengths that MPI goes to to explain the decisions that they made and that they are cross-examined quite stringently by the Intervenors to make sure that the rates that they get are fair and just.

So just making the point that I know -- I know the PUB, for example, puts a -- a notice in the newspaper about these hearings. And I usually see it, because I'm looking for it, but not a lot of people look at ads these days and the way people look to communicate is very different than it used to be. But that's not -- that's not to say we want dozens and dozens of people filing into these hearings to make comments and to -- to give their opinion on how things are going, but I think people just need to know a little bit more about this process and how beneficial it is to ensure their rates are fair and just.

And I'll continue to do the part of CAA to communicate to one (1) in four (4) vehicle owners here in Manitoba, but I think that we should at least consider the opportunity to do a little bit more education about this process and why it's in place for Manitobans. So those are our comments, Mr. Chairman.

Thanks once again to the MPI panel and Board counsel and other Intervenors for the opportunity to -- to sit and watch and listen and take part. And we look forward to hearing what the Board decides. Thank you.

(BRIEF PAUSE)

THE CHAIRPERSON: The panel has no questions. Thank you very much for your comments. I appreciate it. Mr. Oakes, do you have some sense of how long you'd like to -- to --

MR. RAYMOND OAKES: I think I could -- can -- can conclude in roughly the same time that Ms. Peters would take.

THE CHAIRPERSON: Well, let -- let's go ahead then, please, if you don't mind.

MR. RAYMOND OAKES: All right. Certainly.

CLOSING SUBMISSIONS BY CMMG:

MR. RAYMOND OAKES: Mr. Chairman, members of the Board, ladies and gentlemen, motorcyclists are a unique group and their premium increases in the last decade have been in stark contrast to the private passenger whose experience has been flat over that period.

As the Board saw from the cross-examination of MPI and the review of the premium increases over the last decade relating to CMMG IR-2-8 and following, motorcycle premiums over the last year have more than doubled. If the experience had have supported that then that would have been an unfortunate circumstance. But I would submit to the Board that the experience doesn't support that, that motorcycle rates still are not fair or just, and the evidence shows the fact that MPI has been overly conservative and their forecasting has had a bias in favour of the Corporation at the expense of motorcyclists.

At page 1,213 of the transcript it's indicated that MPI is collecting approximately $13 million in motorcycle revenues. Recent years such as 2011 showed their losses of only five and a half million dollars ($5,500,000).

In fact, out of the last five (5) -- out of the last eight (8) years rates have been less than -- their loss ratios have been less than 75 percent of the premiums collected.

Mr. Johnston's explanation at page 1,214 of the transcript reads as follows:

> "It is not something that we can forecast with an incredible degree of accuracy."

And I would suggest that, unfortunately, the estimation that has been used by the Corporation again favours the Corporation at the expense of motorcyclists.

Last -- we saw last year the result of that conservatism. And I think the Board has to go back and re -- reread the previous Chairman's summary of that incident and -- and never forget the situation where this Corporation comes forward and says, well we -- we have probably $350 million we didn't know that we had.

And this whole area bears in on the large issue that we've spent so much time this year on, and that's the setting of the RSR. Because we have a Corporation that has demonstrated overtly conservative estimates. We have a Corporation that has developed a methodology that has every kind of reserve that they can dream up. They have provisions for adverse deviation that seem to keep increasing. Now this year they have an interest rate margin that's increasing.

We have claims reserves, as I've allude -- as I referred to in last year, where they're bloated to an extent that it's almost difficult to believe that the Corporation can develop a situation where they have $350 million that -- as a result of a tail factor that was developed that they had to give back. And I'd suggest that all of that bears on how much of a re -- RSR they need, because really the RSR is just another slush fund that has been developed. And the recent experience certainly doesn't justify its need.

So, in that context then, we'll look at the RSR. The CMMG has not made the RSR discussions a primary part of its intervention over the last twenty

(20) years or over the time that there has been an RSR. Certainly, counsel for CAC/MSOS and the Public Utility Board counsel have far more resources to get into it at a more refined level than the CMMG.

But it would, as a counterpart to some of the discussions, the CMMG would point out that this is a corporation flush with cash. It's a corporation that has over $2.2 million in investments. It has 122 million in equipment and other property. This is a corporation that can borrow. The -- it has $427 million in equity based on the end of the first quarter results. And that's indicated at the transcript at page 1,221.

It spends $12 million on reinsurance. It's backstopped by the Government of Manitoba. The biggest risk, it tells us, is that the Minister of Finance might screw up on the investment side. And I suggest if that occurs that it's the responsibility of the Minister of Finance to enter the fray and again backstop this corporation.

But I would suggest to you the last decade it has showed no problem with rate stability. The problems that we've had have related to the Corporation accumulating too much money that belongs to the consumers of this province. And I would suggest that the overcollection of rates has to stop. It certainly has to stop with respect to motorcyclists.

And it would be our final submission with respect to the argument that motorcycles' rates be reduced by 5 percent, the same as the commercial vehicles, and that it be continued to be monitored until the loss ratios approximate over a decade of a hundred percent. We'd suggest that it has to stop in the collection because the rebate process is extremely expensive.

Last year this Corporation spent sev -- three quarters (3/4) of a million dollars issuing cheques over the course of the two (2) rebates when you consider the cost of postage, creating the cheques, following up on the cheques to see that they're negotiated, the staff time in all of that. And -- and frankly, three quarters (3/4) of a million dollars, from where the motorcyclist sits and from where the public sits, is a waste of funds that could be used in so many other methods. We will be coming to the issue of wildlife initiatives, but certainly fencing of Birds Hill would be a better use of that seven hundred and fifty thousand dollars ($750,000) than mailing out rebate cheques.

With respect to the RSR generally, I've

listened to Dr. Simpson and read the -- the transcript for the portions that I wasn't here for, and the CMMG is on all fours with Dr. Simpson's recommendations and opinions with respect to the RSR.

On another issue that was touched on at length by a presenter, CMMG executive Doug Houghton, I just refer to it in passing for the Board's consideration. It's some -- it's a initiative that may be worthy of consideration in the future. And that was a flap -- flat PIPP rate moving onto the driving licensing revenue, so spread over more persons, which is the concept of insurance generally.

This would be a concept, as I understand it, likely just for private passenger, motorcyclists, all of those who use vehicles for pleasure and for commuting, and perhaps not extending it to a commercial use or classification.

Certainly the system now isn't a fair system. We have twelve thousand nine hundred and fifty-four (12,954) drivers as we saw at page 1,235 of the transcript, or 1.5 percent, who don't pay anything for PIPP. For -- of those, the highway trucks, we saw that their average claims are over $1.6 million annually. We have the issue of the family transfer, which this Board has commented on before which obviously involves an abuse and misuse of the classification and registration system.

With respect to the current response of the Corporation that, you know, we already do this on the driver's licence side, that's a measly fifty-two dollars ($52) and change that is collected on average from driver's licensing.

So what we're suggesting is that there be an examination of this flat PIPP rate instead of, with respect to motorcyclists, where you're punishing victims. This is spreading the cost amongst all who contribute to the exposure, all who drive vehicles whether they have a registered vehicle or not.

With respect to the issue of road safety, the CMMG again is incredibly disappointed with this corporation. No new initiatives. Inadequate funding. Talking about a hundred and eighty-five thousand dollars ($185,000) on motorcycle-specific initiatives out of some $13 million.

Obviously, the Corporation is not demonstrating that motorcycle safety is a priority. It elects to do nothing. There's no research component. The Corporation hasn't identified any plans for the future. There's a complete absence of -- of any initiative at all.

The same -- same situation extends with respect to wildlife collisions. I find this incredibly baffling. We have a $30 million problem. We have Manitoba motorists who are dying. And yet the Corporation sits back and says, We have no plans. We have no initiatives. It appears they have no interest.

The Corporation won't even try rural barriers. There's no plan to examine, say in BC and the Coquihalla Highway, how effective those barriers are. The same on the east coast of our country. Why do these jurisdictions use wildlife barriers if they're not effective.

The Corporation when pressed in their calculations guesses a 50 percent reduction on wildlife collisions as a result of this. I would suggest that the Board order that they examine other jurisdictions, determine out whether it is a 50 percent re -- reduction in collision costs, a 100 percent reduction, a 75 percent reduction, then we evaluate whether that's a feasible expenditure.

I certainly know, Mr. Chairman, what families of the three (3) deceased that we've had in Manitoba over the last decade would say about a fifteen (15) year payback with respect to wildlife barriers, or even a twenty-five (25) year payback. And I suggest that this an area that the board needs to order MPI to be more proactive.

Those are my comments, our application for costs will follow in the ordinary course, and I'm certainly available to add to any of those comments this morning.

THE CHAIRPERSON: We have no further questions, thank you very much for your comments, I appreciate them very much. And thanks for attending for -- during the past few weeks. I -- I believe that the -- opportune time to break now and I suggest we -- we return here at 1:15 for the -- closing arguments from the CAC.

--- Upon recessing at 12:10 p.m.
--- Upon resuming at 1:18 p.m.

THE CHAIRPERSON: I believe we're -- we're ready to resume proceedings, and everybody's at their post. So, Mr. Williams, over to you.

CLOSING SUBMISSIONS BY CAC (MANITOBA):

MR. BYRON WILLIAMS: Thank you, and good afternoon Mr. Chairman and members of the panel. And this morning, I neglected to introduce my clients, which is not good for a -- business relations. So I should have noted that a -- Ms. Desorcy was here this morning, and she's still here ta -- this afternoon. So, so far, so good.

As you might tell by the length of the outline, this -- this might be a lengthy closing argument. Certainly, if you start feeling despair or bleeding from the eyes, I'm prepared to -- to stand down if -- if the panel needs a break.

And there were two (2) handouts this -- this afternoon. One is just a six (6) page excerpt from the record which the court a -- the -- the Board secretary has recommended we mark as CAC Exhibit 33. And...

MS. KATHY KALINOWSKY: Sorry, sorry ---

THE CHAIRPERSON: This is the one dated October 23rd, 2012?

MS. KATHY KALINOWSKY: I'm thinking that's not the correct number. MPI's last Exhibit was 32, and I think CAC is in the teens.

MR. BYRON WILLIAMS: I think that Ms. Kalinowsky is way more on top of that then I am. I apologize, Mr. Chairman.

--- EXHIBIT NO. CAC (MANITOBA)-12:

Six (6) page excerpt from the record

MR. BYRON WILLIAMS: Let's strike the number 33 and call it 12 and a -- the -- the thicker document with the title, "Does Process Matter," I now understand it should be marked as CAC Exhibit 13.

--- EXHIBIT NO. CAC (MANITOBA)-13:

Document entitled, "Does Process Matter? A Regulatory Leap of Faith"

MR. BYRON WILLIAMS: Members of the panel, the title of the a -- of the outline is, "Does Process Matter? A Regulatory Leap of Faith." And no doubt you have concluded by now that -- that I'm some what of a strange person but that my client is not. And you might ask, if you turn to page 2 of the outline: Why -- why the strange title?

And I think to -- to understand that it's -- it's typi -- it's important to understand in a normal rate application, really, the argument of CAC is typically highlighted by a rate recommendation.

Last year, for example, in the general rate application, our clients proposed an 8 percent overall rate reduction because of the concerns that the

Corporation was con -- that it was forecasting excessive costs and demonstrating imprudent expenditure controls.

Last year as well, during the special hearings into the RSR, the highlight again was a rate rebate recommendation -- over 300 million on one occasion, and over 16 million on another -- focussed on a belief that the Corporation was con -- carrying a level of reserves that was inconsistent with the public interest. So normally, from my client's perspective, that's the highlight: the rate recommendation.

And if you turn to page 3 of the outline, you'll see that in this proceeding, again my client has formed the view that Manitoba Public Insurance is likely forecasting exce -- excessive claims incurred costs and has yet to demonstrate prudent expenditure controls to our client's satisfaction. And our client is also of the view that the level of retained earnings is likely excessive.

But CAC (Manitoba) in this hearing is not seeking a rate reduction, and they're not seeking an RSR rebate. Why? Again, you may ask: Why? And from our client's perspective, they see this hearing as an opportunity for a regulatory fresh start.

More times than my client would like to

-- to say over the last few years, this regulator has been at the Court of Appeal with Crown utilities, whether Hydro or Manitoba Public Insurance. And I don't think anyone in this room, or who's been in this room over the past few years, would disagree that there have been tensions in the regulatory environment surrounding the material overstatement of claims liabilities and the unprecedented rate rebate. So there's that background of tension and -- whether expressed in the court or in the hearing process.

And our clients have also noted that when we come into this hearing, that tension is juxtaposed with new faces and welcome faces on the MPI panel, a new external actuary from Manitoba Public Insurance, and a relatively new Board. And from our client's perspective, this hearing is a seminal hearing. It presents an opportunity to create a new regulatory slate, a new regulatory start, a fresh start.

So, again, why? Why, given our client's concerns about excessive costs built into the forecast, about excessive reserves, why aren't they proposing a rate reduction or a rate rebate?

Because in our client's submission on page 5 of the outline, to -- to create this regulatory fresh start, there are material steps needed to move this regulatory process ahead, in their respectful submission. We need to develop some confidence in the claims liability estimating process after many years of consistent overestimation. We need to achieve consensus with regard to the methodology for setting the RSR target, a meth -- a range that is consistent with modern scientific risk analysis. We need, in our client's submission, to begin the process of developing productivity indicators for the Corporation. And we need to fairly recognize the true relationship between Basic and Extension.

And the panel may not recall this discra -- discussion, but during the course of the hearing, we -- our client attempted to engage in a dialogue with MPI about productivity, and we were talking about premiums earned. And in the midst of the conversation, it -- it was almost sidetracked right off the bat because, legitimately, MPI was defending its position about, you know, costs in its view weren't rising too high.

And our client had a revelatory moment there, because their legal counsel doesn't often do clever things, but on this occasion perhaps he did. And he said, Let's leave aside the inflation. Let's just look at what kind of measure we might use to start creating a baseline for productivity indicators.

Let's take the -- the cost and the defending of positions out of this, and let's just look at premiums earned -- or -- or vehicle -- I'll explain this better, but earned -- earned vehicle units. Let's just look at that. Let's leave aside whether there should be an inflation or otherwise.

And then from that moment of rare revelation on the part of legal counsel, CAC (Manitoba) was actually able to engage in a dialogue with Ms. McLaren, not on the inflationary issue, but on what should be that benchmark. What -- how -- how should we -- we measure it?

And reflecting upon that, our clients have -- have taken the position in -- in this hearing, recognizing that always the credibility of the positions taken by CAC (Manitoba) or of MPI, they're always open to criticism on the grounds that they are results driven rather than analytically driven. You can make that argument about either -- either party.

So CAC (Manitoba), in this proceeding, has come to the very difficult decision not to seek a rate reduction or rebate, because they see the greater issue in this hearing is to achieve a regulatory fresh start. And I want to indicate to the panel, especially with my client looking over my shoulder, that that was an extremely, extremely, extremely difficult decision, because our client legitimately feels that there's too much money in the pockets of this Corporation.

And they were concerned, turning to page 6 of the outline, that by focussing on process rather than on a result, that that might be misinterpreted as a lack of conviction in the conclusions of their an -- analysis. So I certainly wish to assure this panel, and hopefully you saw it in the course of my cross-examination this morning, that our client is fer -- fervently of the view that there is too much in the -- money in the pockets of the Corporation. But in this hearing they say that the bigger focus, the more important focus, is getting some of these process issues right.

And hence, my client's regulatory leap of faith. My client is saying, Please don't misinterpret our lack of focus on rate reductions as a lack of conviction in our views. Please interpret it as a conviction in the need to set a good regulatory course for the next few years. And certainly not to disagree or criticize what has happened in the past, because there were monumental achievements, but it's time for a fresh start, from our client's perspective.

And that's why they're taking what I believe is the unprecedented position, after forming the conclusion that there should be rate reductions, not to seek one; after forming the conclusion that there should be a rate rebate, not to seek one. And, certainly, I can't say with certainty it's unprecedented. I've only been around for about fifteen (15) years. But certainly in my experience, on my client's behalf, it's unprecedented and a difficult decision.

At page 7, I -- I highlight, very briefly, focus group and advisory group. Again, any opinion presented in this proceeding is the opinion of CAC (Manitoba), expressed to me by Ms. Desorcy through their board. But it is important to know that the board input is only part of the CAC (Manitoba) process.

Certainly, there was a focus group undertaken in September discussing issues such as opportunities and risks associated with road safety; and also from the focus group's perspective, priority issues; a discussion of the relationship of Basic with other lines of business; and a discussion of the extent of knowledge, if any, of -- of participants of the competitive options for other lines of business.

And just last week, my client certainly undertook a number of advisory discussions -- two (2), at least, to my knowledge -- again with interests groups or groups representing different perspectives or individuals representing different perspectives from CAC (Manitoba).

And, again, the comments canvassed issues such as the opportunities and risks associated with road safety, the relationship of Basic with other lines of business, the purpose of the RSR, the issue of whether there should be an RSR, and the issue of risk tolerance, and -- and, again, the issue of what should the RSR be used for.

So I -- I certainly will not share who par -- our clients participated with or I will not articulate anything that our clients do not believe, but the Board should understand that that was part of our client's process.

On page 8, we just very briefly discuss sources. And in the course of -- as you go through this volume of out -- the outline -- voluminous outline presented by my client, you will see from time to time, in brackets, a page number, maybe page 989, et cetera, or you might see "Johnston" and -- and with a page number attached.

Generally, tho -- those are excerpts from the re -- record that our client is presenting. I want to be clear. We have provided the page numbers. Sometimes they are precis or summaries, our interpretation of that -- that question. We've inserted the page number so that the panel can, or others, can -- can check the references.

If someone said, "And -- and I," especially, if it was Mr. Williams, I tried to take that -- that out as well. So it won't be an exact quote in most cases, but it will -- and certainly in our client's view, be a representative statement from the record.

So at page 9 we really set out the legal test, the same legal test that our client enumerated in its opening statement. And I won't take you through it at this point in time except for to say that, from our client's perspective, a number of the disputes between MPI and the PUB, and perhaps between the PUB and Hydro as well, may evolve in part from the lack of clarity regarding the legal test.

And certainly in the last PUB general rate application relating to Hydro, Order 512, our clients recommended that the Board present, you know, the -- the legal criteria that it was applying. And in

-- in the context of -- of this hearing for Manitoba Public Insurance, again, that would be our client's recommendation.

We proposed a test on page 9. We hope you'll adopt it. But that is certainly the test we would -- we would submit, and -- and from our client's perspective, it's helpful to all parties if we understand expressly the criteria the -- the tribunal is aiming at.

And certainly, the statutory test is a just and reasonable rate under Section 77 of the Public Utilities Board Act. In our client's view, this is an accurate representation of what that test means for Manitoba Public Insurance.

So flowing from that test on page 10, you'll be relieved to see there's not a lot of words there. Are the forecasts of revenue and costs reasonably reliable? Really, the first part of our client's test.

And as we turn to page 11 and for a few pages afterwards, it is important to talk, when we look at forecasting, about checks and balances, because if you think back to the opening statement and the direct evidence of Manitoba Public Insurance in the first day of the hearing, a lot was made of checks and balances.

There's the auditor. There's the external actuary. There is the -- the budgeting process. Throughout the -- the course of this hearing, those checks and balances were highlighted. And we've put a couple of summaries from the record, noting that in the forecasting pro -- bala -- process, both the external actuary and the external aditor -- auditor are considered to be checks -- checks and balances. And obviously, in the review of policy liabilities they both play a central role.

At page 12 we make the simple point that checks and balances do not always work. And that was never made more evident than in the material, in fact at massive variance, between the forecast for rate setting and actual claims liabilities.

There's the fabulous Information Request, if I do say so myself, on the record, CAC-1-56, that sets this out. And we also canvassed this in the transcript at pages 918 and 919.

But look at the variance between the forecast for rate setting and actual claims liabilities in '08/'09, $96 million, a variance of minus 15.6 percent; '09/'10, $109 million, a variance of minus 17.5 percent. And we all know what happened in 2010/'11.

Set out below are just a -- a brief discussion from -- from my conversation with Ms. McLaren and Mr. Johnston. I asked:

"At any time between '04 and '05 and 2010/'11, did MPI receive a report from external auditors suggesting it would be unreasonable to rely on the final overall estimate of claims liabilities pro -- produced by the external actuary?"

And Ms. McLaren's answer is, "No, we did not." And again, we also noted the -- the quote that is beneath it, you can read it at your leisure, that certainly on at least one (1) occasion, the external auditor signed off on the overall estimate of claims liabilities of the external actuary, even while finding certain specific estimates for particular lines of business were beyond the range of reasonableness.

This is not to -- to destroy the external audit process. It's a very valuable process. It is not to destroy the external actuary process. It's a very valuable process. It is just to recognize that it's not a perfect process. It's -- like any process, it's replete with human strengths and human frailties.

At page 13 we look at another check and balance articulated by MPI, and that is the three (3) step budgeting process. And certainly, it starts with the development of the application, and then there's the develop of the guidelines -- development of the guidelines. And that's a critical step, because essentially that's intended to be -- support what's presented, determined in April, and underlies the application. And then there's the actual budget itself, which takes place sometime later.

And at page 14 we simply summarize, both from MPI Exhibits 25 and 26 and also from the transcript, the fact that in both the 2011/'12 year -- and I've got the -- the next year misstated. It should be 2012/'13, not 2011/'13, which would be a very ambitious financial year.

We make the point that the approved budget normal operations was higher than the guideline: 3.3 million in 2011/'12, about 1.5 percent; and 4.6 million, or almost 2 percent, in the two (2) -- 2012/2013 year. So again not to say that this isn't an important check and balance, but to note simply that these guidelines can be, and have been, exceeded.

And certainly, when our clients proceed on a regulatory fresh start with this Corporation, and you -- certainly, this panel has seen it in our ex -- increased alertness to actuarial issues last year and again in this year, our client's recognition from the past is that at time is the rate-setting process may have been too deferential -- deferential to the opinion of external aud -- actuaries and auditors. And again recognizing be -- that behind these -- this barrage of -- barrage of numbers is an essentially human process replete with strengths and weaknesses.

Turning now to for -- forecasting at page 16 of the outline, Mr. Chairman and members of the panel, we make the simple point -- and this -- this is evidence provided by Mr. Johnston -- of the critical importance of historical in -- experience in forecasting and how the forecasts of the Corporation are inextricably linked to the IBNR review of liabilities. And again, if you've got the base too high, there's a risk you'll overstate things going forward.

So we asked the question at page 17: Are the forecasts of claims liabilities reasonably reliable? And we remind this panel what our client submitted last year. In that hearing, our client articulated their perspective that there was consistent cumulative conservatism, including the selected development factors, the tail factor, and the selected methods, in particular focussing on two (2) lines of business: accident benefit weekly indemnity and accident benefit other.

So what's the state of the union, from our client's perspective, this year? First of all, again perhaps in -- in light of the fresh start, we do want to offer a compliment. In terms of the Corporation's approach to accident benefit week -- weekly indemnity, our clients have seen a material improvement in the Corporation's approach in -- in that particular line of business, and they do want to commend it.

Like My Friend, Mr. Oakes, though, our clients do have a concern in this particular Application with the increase in -- of twenty-five (25) basis points in the interest rate provisions for adverse deviation. And they reiterate their concern from last year, in terms of the accident benefit line of -- other line of business.

So let's focus on the twenty-five (25) basis point increase in the interest rate PFAD. My friend, Ms. Grammond, this morning said it was a $34 million difference. I've said 33 million. It's somewhere up there. It's a big number flowing from the decision to increase the provision by roughly twenty (20) -- well, exactly twenty-five (25) basis points.

And our clients have a coupe of concerns -- in fact, three (3) -- with the reasoning behind the twenty-five (25) basis points, or -- one of them, frankly, I don't think I articulate that well. But My Friend, Ms. Grammond, I thought, expressed it very eloquently in her cross-examination of MPI at page 519 of the record.

And she wasn't focussed on the PFAD for the whole line of business, but certainly on the non-indexed coverages. And she was suggesting in her discussion that a fixed interest rate margin -- as it represents an increasing proportion as interest rates decline of the assumed interest rate, why would declining interest rates call for an increase in the interest rates margin. And again, that's limited to the non-index coverages, and it's certainly -- perhaps a smaller point, but an important point, raising some -- some concerns.

At page 19, our clients express a more fundamental concern, from their perspective. They note, as My Friend, Ms. -- this is page 19 of the outline -- as My Friend, Ms. Grammond, did in her statement this morning, that in terms of this twenty-five (25) basis point adjustment, the driver of the external actuary's concern appear to volatility, coupled with high inflation -- in that particular year, about 3 percent -- and the lower trending interest rates.

My client's concern though is that adjustment would appear to at a -- odds with the best estimates of the direct -- direction of interest rates and inflation. And we note here -- and we bolded a quote from Mr. Johnston, saying that, We don't believe that we have better information than the banks or the professional forecasting agencies to forecast interest rates or infla -- inflation rates; we rely completely on them and generally select a median forecast.

So turning to page 20, what are these best estimates saying? What are these forecasts saying? Well, if the external actuary was concerned about a -- a CPI at 3 percent, certainly the best estimates are suggesting a more moderate CPI at 2 percent per annum, roughly 33 percent lower then the fors -- compared to the actual's in 2011.

Moreover, these estimates suggest an in -- increase in interest rates going forward and with the Corporation forecasting over time, what I characterize in my question to MPI, is a fairly robust growth in interest rates.

So that's a -- a second and, perhaps, more material concern with the PFAD interest rate adjustment of twenty-five (25) basis points. And our third concern is articulated at page 21.

And on some points, certainly when it comes to the DCAT, our clients are going to take issue with the evidence of Mr. Johnston. But they will note that at certain parts in this hearing, he was certainly very persuasive, but not on this point.

In terms of the basis -- twenty-five (25) basis point adjustment, Mr. Johnston was far from persuasive. And remember, 1 percent is where it was, and the external actuary wanted to move to a hundred and twenty-five (125) basis points. What did Mr. Johnston have to say?

> "I can't guarantee that for example, the appointed actuary may decide that they no longer need that -- that PFAD that -- that they added last year."

I apologize, Mr. Johnston, I didn't take out the "that's" that time, I'll a -- I did take out most of mine though, I have to tell you.

What else did he say? I've always found that the selected -- our selected margin, which has been 1 percent up to this time, I found that reasonable. And I'm precising here. And he provides his reason for that. And then on pages 525 to 526 -- because clearly, this issue was -- was bothering Mr. Johnston:

> It's possible that our appointed actuary may decide that the provision that was added last year is no longer required."

And then at the top of page 526, my favourite quote of Mr. Johnston's from the hearings, just after -- just after he had said, "I'm not going to talk about it anymore," he goes, In my -- how he talked about why, I thought 1 percent was reasonable, and I do think it's reasonable for such a long-tailed business.

We put the quotes -- the page numbers there, you can go to them at your leisure, but there's Mr. Johnston, certainly in our client's perspective, less than devout in his support for the twenty-five (25) basis point adjustment.

So where does this leave us, from a regulatory fresh start recommendation? Our clients are certainly recommending that the PUB find that there is conservatism in the move to a higher PFAD for interest rates that -- that has a material impact on claims liabilities. But our clients also recognize you've got a new external actuary, there was a significant release of reserves in the current year, and we can understand some conservatism in the actuary flowing from that.

So from our client's perspective, they certainly would be satisfied with the PUB putting MPI on notice that if current interest rate forecasts are borne out, and inflation rate forecasts as well, this provision will be considered carefully for its reasonableness in the 2014/2015 GRA.

So our clients are concerned; but recognizing new actuary, there's been some significant releases this year. They certainly intend to aggressively pursue this point next year if that remains in. But they will move a little more cautiously this year, recognizing that new actuary and that fresh start.

Turning to page 23. Our clients, last year, both in terms of accident benefit weekly indemnity and accident benefit other, outlined a concern with what they consider to be compounding conservatism. And what our clients mean by that is if you think of the sensitivity of the estimates of IBNR, incurred but not reported, it can flow from three (3) different factors. One is the selected development factor. Another is the tail factor. And the third is the selected method.

And if the panel would turn to CAC Exhibit 12, which is the -- the skinny, little excerpt from the record, to the very last page, they will see -- we haven't marked it as this, but this is the document that generally appeared as CAC Exhibit 8 in the course of this hearing. And at the -- there should be some yellow shading on that page, and it looks like everyone's got that page.

Before I go to this document, our clients should note that MPI cooperated with them, with CAC (Manitoba), in the development of this exhibit. They indicated they would come back if they disagreed with any of the numbers.

And MPI -- if you see some handwriting at the bottom of that document, you'll see some handwritten numbers. And -- and those are kind of the revised calculations for two (2) of these columns by Manitoba Public Insurance. So while our clients are actually pretty confident in their exhibit, they've chosen to put in -- and with appreciation to Mr. Johnston, the MPI figures for those two (2) particular columns.

So -- and going back to that idea of --

of compounding caution, again flowing from develop -- the sel -- the selected methods, the development factors, and the tail factors. If you look at the top table there, you will see at the extreme right the selected -- the selected factors of Manitoba Public Insurance leading to the IBNR of accident benefit others of $39.5 million.

Now, we went through this in cross, so you don't need to -- I don't need to drag you through it today. But our clients would encourage you to compare their selected method to the results from any other method presented on this table. And you'll see that the selected method of Manitoba Public Insurance is -- is higher than the other -- other methods there.

Mr. Johnston and I had a dialogue. He wasn't prepared to concede that that was conservative. Our clients take a different view. But they point out that it's not just this choice in isolation. It's this choice when you read it together with the development factors, the selected development factors, and with the selected tail factor. And if you're looking for a summary of those numbers, that's on page 24 of the -- of the outline.

What about the development factors? Well, what our client would draw your attention to --

first of all it's a small change -- but just to show the sensitivity of -- of this. What -- the third column in -- in the bottom part of that table just looks at the latest three (3) volume weighted selected -- selected factors. Essentially what -- what that third column is doing is comparing what -- what would happen if you took just the -- the latest three (3) as compared to the MPI selected factors and leaving that big old tail factor unchanged.

Well, what's the difference? If you go to Mr. Johnston's number, rou -- roughly 2.5 million. Well, move over two (2) columns and just see what would happen if you took the simple average out of the middle three (3) of the last five (5)? Then, all of a sudden, you're getting to a $17 million difference.

Now, again, we've had discussions with MPI in the past about -- in terms of selected factors. They say that they can't be driven exclusively by averages. And certainly, our clients agree. But, again, look at the selected factor compared to the averages. Again, certainly in our client's perspective, a bias to -- to the higher figure. The big -- the big number is on the extreme right, and our clients have taken an -- really a -- perhaps an extreme scenario, not too extreme, but what would happen if you took out that tail factor on the incurred side?

How much of a difference would it make if you went from the zero point three-four-five (0.345) to zero? Thirty four million dollars ($34,000,000) is Mr. Johnston's and his team's calculation.

Our clients also asked: Well, what if you -- if you didn't take away all the tail factor? What if you reduced it by less than half, put it down to point two (.2)? And that's not on this exhibit, but if you went to PUB 29, you'd see that difference was $13 million less.

So again, Mr. Chairman and members of the panel, compounding conservatism -- in isolation, perhaps maybe the development factor, well, you know, you could -- you could disagree. In isolation, maybe the -- the method, perhaps you could disagree. In isolation, maybe the tail factor, you could disagree. Put them together, and all of a sudden you're having some pretty material changes, which our client, while they're satisfied at the progress MPI's made with accident benefit weekly indemnity, they are definitely not satisfied with this progress.

And at -- at page 27, our client articulated a -- a convers -- of the outline, you know, we can put this document away for a second. At page 27 of the outline, our client was following up a discussion that Mr. Johnston correctly pointed out, there's a lot of uncertainty there.

So our clients asked, Well, have you gone to SGI? Have you asked them what they're doing? Are they using workers' compensation data to -- to help to allay that uncertainly? Are they using information from the SS -- excuse me, SAAQ, from Quebec? And Mr. Johnston's answer, candidly, was, No, I have not.

Our clients asked, Well, would it help? And here's his answer:

> "I suspect that getting more data in this regard could add -- regard [excuse me] could add value. I don't know to what extent and whether it would change it."

But there -- there you have his point. And so our client's concern is that this is still a significant factor for -- for the IBNR. To protect against uncertainty, MPI has chosen three (3) relatively conservative approaches, in our client's perspective, and not sought out other information that might help give it more certainty.

And certainly from a recommendation perspective, turning to page 28, our clients are asking the PUB to conclude that there continues to be conservatism built into the estimate for ABO and that MPI be directed to investigate techniques used by other Crowns operating no-fault for analogous lines of business.

And by "analogous", I think Mr. Johnston would -- would argue that there may be little tweaks in what SGI has, for example, in terms of how they describe accident benefit others. It might be called personal care there. But certainly, our clients would encourage that sort of investigation, because when you're -- when -- from our client's perspective, when you're dealing with that much uncertainty, they're not very comfortable to see three (3) different compounding conservative assumptions.

Turning to the -- the next part of our legal test, being: Are base costs and forecast costs prudent and necessarily incurred? The panel doesn't need to -- to turn there, but on page 30 -- 30, our clients are trying to summarize some of the concerns outlined by this Board last year.

And on the very first line, you're going to see the words "PB", and you're going to wonder, What the heck does that mean? Well, you might not swear, but that -- that's actually a typo. It's -- it was for the Basic program. So BP or Basic program is what that was meant.

But this is the Board last year expressing -- expressing significant concerns, in terms of Basic program compensation expenses. Express -- expressing significant concerns in terge (sic) of -- in terms of large IT expenditures and the business process review, or BPR, without apparent correlation of personnel productivity, expressing concerns with IT optimization, and asking whether we could do more to get bang for -- for the buck for road safety.

In terms of this year and prudence and reasonableness this year, the -- the panel does not need to turn -- turn to it, but I would simply note that our clients actually, in their opening statement, CAC Exhibit 3, had a pretty good statement, in terms of the issues they saw as -- in terms of prudence and reasonableness this year. And -- and I will not re -- repeat it, but just direct that to the Board's attention at the part -- particular time.

And the reason our client is not focussing on what continue to be some concerns but also some compliments for MPI is because their focus, in terms of the pre -- prudence and reasonableness of rates, is not going to be, in this particular year, on whether we can knock off 5 million or 7 million in terms of their expenses.

Our client's focus is:  Can we get this productivity indicator discussion moving?  Can we get this benchmark discussion moving?  And so please don't misinterpret our client's lack of comment.  Operating expenses, claims expenses are always a material concern but the want to focus a little bit more on productivity indicators.

Having just said -- said that, on -- on the next page I do outline what our clients do consider, on a going-forward basis, to be matters that should be cause for continued stringent scrutiny.  The first we talk about is corporate staffing levels.  And frankly, our clients were a little confused by the -- the change in -- in the presentation of the information this year.

But they do note Ms. Grammond's comments in terms of the increase to -- to nineteen (19) -- one thousand, nine hundred and seventy-one (1,971) on a corporate level from this morning.  So that's an item -- an area of continued scrutiny from our clients, certainly in future -- future years.

And our clients, at least at a high level, do wish to express some discomfort with the apparent divergence between claims expenses costs and claims incurred, and I'll explain that in a minute. And also the divergence between operating costs, claims expenses, and CPI.

And our clients do want to focus on productivity indicators, but they just want to illustrate what is giving them a bit of concern. And again if the panel wanted to go to CAC 12, that's that little -- the -- the short, little document, just for a second.

And on the very first page after the cover page, you'll see an excerpt. It should be marked, "CAC/MPI-1-148 Attachment," in the top right-hand corner. And again, we had some discussion about this. Basically, the -- if you look at -- towards the bottom of the line, the -- the dark line is -- is basically the CPI trend, and you can see that it moves fairly closely with net claim -- claims incurred per vehicle. So certainly from our client's perspective that's a happy relationship. That's one they like to see.

Where our clients have some discomfort -- and -- and this is where, in going forward, this issue, from our client's perspective, needs to be examined more closely, is the divergence between claims expense per vehicle as measured on this table and net claims incurred per vehicle as measured on this table. And that's -- certainly, historically, our client would have expected this -- this pattern to move on a much closer relationship.

Now our -- again, our clients are not going to the barricades on this issue this year, and they note a conversation with Mr. Johnston which was -- was helpful. And he was suggesting that the indicator might or might not be more useful if you took out PIPP costs and looked at collision costs, and -- and it might show a more -- a more helpful relationship, or a more -- might give more insight or it might not. And my under -- our -- our client's understanding is that they -- MPI will be looking at -- into this issue next year.

But it's an important point. And certainly when we get into the modelling of Manitoba Public -- Public Insurance, you'll see that in some of their scenarios, I think the combined scenario, they make certain assumptions about the relationship between claims expenses and claims incurred. And certainly, that relationship does not appear to be borne out by this table.

If -- if I haven't distressed you too

much with tables, if you flip over one (1) more page, you'll see an excerpt from CAC-2-76, the attachment. And, again, this table is -- is very burdensome to -- to explain. There's a good discussion of it on the transcript. But essentially, what it's trying to -- to track in the seventh column is the difference between -- at -- on the top, what would happen to Basic ex -- claims expenses if they rose by inflation as compared to how they've actually risen over -- since '07/'08, in terms of MPI. So that's the top side.

On the bottom, the same kind of analysis is done, in terms of Basic operating expenses, as how much they would grow by -- if they were growing by inflation, as compo -- compared to how much they would -- they would have grown if they were -- or, how much they did grow under MPI.

And what you'll see, Mr. Chairman and members of the panel, is generally, with one (1) exception, that the growth in claims expenses and operating expenses since '07/'08 has tended to be higher than inflation. Again, we can -- we can have an extensive debate about: Should we be tracking MPI based on exten -- on inflation. But, again, this is a -- a cause for increased scrutiny from our clients going forward.

So I'm going to flip you all the way to page 34 of the outline. We've jumped a massive number of pages. And our clients want to -- to engage in this discussion of benchmarks performance indicators. And from -- from our client's perspective, it hasn't been a very satisfactory discussion over a number of years. And certainly, some of MPI's evidence sugg -- suggests they really -- there's almost a mixed record.

Because at certain points in time, MPI suggests a lot of loyalty to those really broad benchmarks: the relatively lowest rates in Canada, a certain -- you know, a certain percentage of premiums returned to clients, et cetera. And from our client's perspective, those aren't bad indicators. But they're really, as we note on this page, more indicators of the strength of the -- the Autopac model and of the no-fault model as compared to the Corporation's efficiency.

And so the point we make on this page is that those type of performance benchmarks traditionally favoured by the Corporation are often a reflection of the strength of the model than of the management of the Corporation. They have a monopoly in Basic insurance. There -- as they're -- they're quite frank in their evidence. There are massive advantages that flow from that, in terms of economies of scale.

They have a no-fault system, in terms of personal injury. And there are massive advantages that inure to the process in terms of cost certainty and some efficiencies -- less lawyers, for example -- that flow from that. So from our client's perspective, those macro indicators may tell us something very positive about the policy choices that Premier Schreyer made back in the '70s, or Premier Fillmon made, in terms of no-fault, in the 1990s. But they don't tell us as much as our clients would like, in terms of productivity of the Corporation.

At page 35 of the outline, our clients note that while MPI seems resistant and, at times, almost to suggest that there's little that can be done in -- in terms of getting applicable benchmarks, there are some examples even within this record of where benchmarks have been utilized and very useful. And the Gartner Group is perhaps the best example of that. Those IT benchmarks have provided, from our client's perspective, a significant level of insight.

So at the bottom of this page, our clients ask -- well, let -- let me start at the top. We confirm that MPI sees some value inuring to it -- I-N-U-R-I-N-G -- in terms of the assistance Gartner Group has provided, in terms of benchmark analysis. So at the bottom of the page we -- we go to the question: Well, are you seeking any other external consultants?

And Ms. McLaren candidly says, We've dabbled a little bit, but nothing that we're really -- that we've really latched on to. And certainly, from our client's perspective, this is probably an area where -- where MPI could be doing more and seeking some outside help. Often, we're not that keen on them seeking external consultants. This one may be an area where, from -- to our client's eyes, they may be struggling a bit, and external help may be of value.

On the next page our clients asked, recognizing the value from the Gart -- Gartner Group: Is there something inherently unique about information technology that allows you to look at external comparators or other -- other areas where that might be fruitful? And Ms. McLaren, again candidly said, I think there are likely some others.

So from our client's perspective, that's an important point, that there are more opportunities in terms of external benchmarks then perhaps our discussion in past proceedings has led us to conclude.

Page 37, we highlight one of those areas where MPI seems to be making some progress, in terms of establishing key metrics. And that's on the bodily injury side, in terms of the number of files handled by employees. And the evidence from MPI is that they may be able to provide some productivity bench marks and bodily injury within the next year. So while our clients are often critical of MPI in this regard, we see some progress, at least in that limited area.

And at page 38, our clients also see some colms -- cause for common ground. Going back to my opening statement, where I talked about once we got -- quit talking about money and talk -- start talking about process, we asked MPI: If this regulator is looking for some productivity comparison for this corporation, is the Basic earned unit a suitable vehicle? No pun intended.

And MPI's response was, Earned vehicle units may very well be. Of course Ms. McLaren wasn't walking down my CPI path, but at least we had some common ground in terms of the common measure. And then she made an even stronger play -- statement:

> "But absolutely, earned units are key, and I agree that in some fashion, tracking against that may be appropriate."

And so, from our client's perspective,

that was an important point in a -- an important point of common ground. If you go to a -- TI.2 of the Application, you'll see how central the earned units are to the rate-setting process. It's a good place to start. And from our clients -- we were -- that's certainly where they would start as well.

So in terms of productivity indicators, where do we go? Certainly we'd recommend that MPI seek some external assistance analogous to the Gartner Group for the development of productivity indicators; that MPI be directed to report back for next year on using earned units as a base -- fo -- to propose productive -- a productivity benchmark, including a proposed productivity indicator, proposed growth rate, and base year.

And certainly our clients suspect that we, in terms of what the proposed grate -- growth rate is, there may be some disagreements. But at least it's a starting point.

And also recognizing that -- that there is a bit going on in terms of MPI, certainly on the bodily injuries side, MPI to provide an update of current productivity measures in place, including, information technology, bodily injury, call centres, and proposed next steps.

Mr. Chairman, I'm about roughly halfway through maybe -- I'm happy to keep going or -- we're getting to a long spot. So I wouldn't -- I -- I -- If you want to take a -- just a very brief break, this would be a good -- a good time.

THE CHAIRPERSON: Why don't we do that? Let's take ten (10) minutes and back here at twenty (20) after 2:00.

--- Upon recessing at 2:11 P.M.
--- Upon commencing at 2:22 p.m.

THE CHAIRPERSON: I believe we're ready to start, Mr. Williams?

MR. BYRON WILLIAMS: Thank you. Just the headline at page 40 is, "Taking into Account Risk: Is the Basic Line of Business Managing its Revenues, Reserves, and Retained Earnings in a Reasonable and Prudent Manner."

And at page 41, Mr. Oakes alluded to this, the one (1) exception from my -- from my outline where we didn't actually provide a citation. But historically, this panel has looked at the strength of the Corporation as a whole, and this is a peek at it as of February 2012.

We see the Basic retained earnings roughly in the $210 million range if AOCI is taken into account for some person -- some purposes. Anyways, it gets it up to two-sixty (260). We see the Extension, SRE, DVA family around 160 million, with AOCI of around nine (9). And from a cumulative basis, certainly a healthy bottom line, in terms of retained earning -- earnings, in the range of 373 million and adding in AOCI in excess of 400 million.

So the conclusions our clients draw from this is that overall, in terms of ana -- analyzing these issues, this is a corporation that is in a healthy overall financial state. An argument can be made, successfully, that it is over-reserved. And we note as well the conversation the Chairman -- Chairperson has had a couple times with MPI, certainly to date, our clients are -- are not aware of any commitment from MPI to return excess reserves to ratepayers through whatever mechanism.

So the RSR. During the course of this hearing, and I -- I think Ms. McLaren and I probably go back to the -- some of the early debates over -- over this. Maybe neither of us was in the front row when it -- when it took place. But Ms. McLaren really well articulated kind of the roots of some of this discussion.

You know, how do we get to this place. And certainly, you know, there was a big, horking rate increase proposed for the 1988 insurance year in the range of 25 percent. "Horking" is perhaps not the appropriate legal term; I'll strike that. A big. What was it driven by? We had that discussion on the transcript. Three (3) major factors: budgeting for loss, deficiencies in forecasting related in -- in part to the lack of actuarial expertise, and an adverse event. So certainly from our client's percep -- perspective, when we look at the RSR it's important to understand that it's only part of a proposed menu to -- to the 25 percent proposed rate increase in 1988.

What are these other mitigation tools? Well, improved forecasting, an end to budgeting for loss, and again in the 1990s, another big response arguably was no fault. So in many ways, from our client's perspective, the key mitigation tools are better forecasting, not budgeting for loss, and -- and the rate stability flowing from the inherent strengths of the no-fault model.

Not to say that -- that the RSR -- that there should not be one. Certainly, from our client's perspective, it is important that there be a level of retained earnings to cushion the impact of an adverse event. But it is important to put the RSR into -- into context and to recognize while it tends to assume a disproportionate place in the debates of hearing after hearing after hearing, that's almost more a function of the rate-setting process than it is of -- there are other far more important tools available to the Corporation to -- to mitigate adverse events. So this is an important debate, but there are -- there are other important debates that -- that should take place.

It is important and -- and certainly to look at -- at history and -- and to -- to examine what happens if the doomsday scenario happens. And Mr. Triggs tried to pose that question to Dr. Simpson in cross-examination. And I certainly posed that question to -- to Ms. McLaren in -- in the -- in the course of my cross-examination of her, and she went back to history.

And we see the negative retained earnings of roughly minus 50 million back in the mid-1990s, certainly a more extreme scenario than Mr. Johnston talked about this morning. And what happened? Well, that first year -- and I think that was my first hearing as head counsel; almost got fired that year -- there was a rate increase and a 2 precent RSR surcharge. Next year, there was an additional 2 percent RSR char -- surcharge. And the next year a 1 percent RSR surchar -- charge. Then it was rapidly reduced.

So a graduated response to a pretty extreme event. And certainly, I posed that question to Ms. McLaren, and you can look at the transcripts, page 1105 and 1006:

> "It is conceivable that if the RSR is outside its target range, MPI will ask for a couple of percentage points to rebuild the RSR?"

Ms. McLaren agreed and then used this example. And that -- that's significant, from our client's perspective, because, quite frankly, they were surprised when they saw MPI Exhibit 32 and -- and the extreme 15.6 percent response to an adverse scenario, because it was that type of response was inconsistent with our client's experience in the 1990s. And from our client's respectful perspective, it was inconsistent with the response provided to us in cross-examination by Ms. McLaren.

Now, you can look at that deficit in the 1990s of minus -- minus $50 million from a few perspectives. In a way, because we have a larger RSR target, it's a steeper hill to climb to get back to the target if you're at minus fifty (50). But at the -- at the same time, they were working off of a smaller premium base in those days.

So that kind of gradual response, to our clients, is a far more plau -- plausible scenario than the extreme scenarios, in terms of responses presented by Mr. Johnston in Exhibit MPI-32 this afternoon.

So what is the RSR for? At page 44 we asked that -- this question. And frankly, it was stimulated by a really interesting cross-examination by My Learned Friend, Ms. Grammond, of Mr. Johnston. And what does MPI say the RSR is for? Well, it's very clear it's not a solvency test. Page 985, Mr. Johnston said -- and said, While it might look like a solvency test, it's not.

And so originally our client was thinking, This RSR, from MPI's perspective, must be about rate shock, has to be. And certainly the words used by Mr. Johnston in his discussion with My Learned Friend was, "significantly prevents rate shock."

And at page 1001 he said:

"It will aid in preventing significant rate increases, rate shocks."

And Ms. McLaren said something to the same effect in terms one other question we were asking:

"What are plausible -- plausible
risks that could destroy the capital
and cause rate shock for ratepayers
to recover the capital?"

And she gave some example of what she thought rate shock would be in the six (6) -- the context of a 6 percent increase the year after a substantial decrease. So there we are. We think we have MPI's explanation of what the RSR is for -- RSR is for: rate shock.

But turn to page 45 of the outline. Maybe it's not about rate shock. Maybe it's about predictability and stability. And as we tried to explore the definition of "rate shock" with the Corporation, Ms. McLaren said:

"It's really about need -- meeting
the needs of Manitobans for
predictability and stability. That's
what we're talking about here."

And at page 1000 of the transcript, she says at line 12 that:

"The definition of the RSR, which
doesn't necessarily tie directly to

rate shock, right, it's about protecting Manitobans from one (1) time events."

So it's not solvency; maybe it's rate shock, maybe it's this predictability and stability. Is there any more? Is there any more explanations of what it's for? At page 46, Mr. Johnston offers, in our view, another angle. What's the RSR for? Look at -- look what he's saying around line 10:

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

Here, Mr. Johnston does not appear to be talking about rate shock; it's about protecting the Manitobans from having rate increases. Does it mean any rate increases? Hard to -- hard to say.

So certainly, from our client's perspective, there's some inconsistencies in the Corporation's definition of what the RSR is for. And our clients agree with Ms. -- Ms. Peters on behalf of CAA, that may -- that -- that perhaps a starting point is going back to: What do we actually mean? Is it really as per, one (1) interpretation of Mr. Johnston's words would be, preventing any rate increase arising from an adverse event?

Certainly our clients think that is an extreme position. And certainly, if that's where Mr. Johnston, in his DCAT analysis, is starting from, arguably he is creating excessive protection, so -- in his design of the RSR so that there is no rate increase from adverse events.

So at page 47, we make what we think are the key points from this discussion: that there appears to be confusion by MPI over the purpose. It looks like solvency, but it's not. Sometimes it's about rate shock, but not necessarily. Maybe it's about predictability and stability, or maybe it's about pre -- preventing any rate increase.

And our clients are concerned that the aversion to any rate increase may be driving conservatism in the Corporation's DCAT analysis. And especially when -- we'll turn at this point in a couple of moments -- when we're considering that the -- the DCAT is already coming from a private sector mind-set. So there's some adjustments already associated with it, which I'll elaborate on.

So what do our clients say? What is their perspective about the role of the RSR? From our client's perspective, the primary role of the RSR is to protect against, highlighting the word, excessive rate increases flowing from unpredicted, non-recurring events. Put another way, a cushion so that if a material and rarely occurring event takes place, we can take a measured response to recovering from that event and rebuilding that cushion.

From our client's perspective, the RSR should not be designed to prevent any rate increases flowing from adverse events. Excessive rate increases is -- is central to our client's perspective.

Why? Page 49 -- and certainly, Professor Simpson articulated this better than -- than my inelegant words can. While the -- while the RSR is there to -- to protect against excessive rate increases arising from rare and material events, there are costs associated with it. And certainly from a consumer perspective, there are opportunity costs for consumers. And MPI actually put this quite well in cross-examination, when we were discussing the time value of money.

Money, today, in our hand is far more valuable to consumers than at some -- the same amount at some future point in time. It could be earning interest. It could be used to something that advances their social utility. And there's always risk or uncertainty associated with future cash flows.

Professor Simpson put this well when he said:

"We have a belief that persons can make good choices in their own self-interest."

And our clients believe this ferventy -- fervently for all consumers. But issues and opportunity costs are particularly important for those on fixed incomes or lower incomes, modest incomes.

There's also a potential risk to -- to -- from excessive reserves, from our client's perspective. And certainly, the Board will see in prior Board decisions words such as "moral hazard." A concern that an excessively reserved Corporation will be prone to excessive expenditures. And our clients can think of no better example than the IT optimization fund last year.

When that money was in retained earnings, when MPI could go to it without having to put it into the rate base, it came before this Board with a $71 million figure. When the Board, to its credit, said, No, come back, MPI came back with a materially different figure. We can all interpret what happened in that occasion, but from our client's perspective, that's always a concern.

One of the central points made by Professor Simpson goes to the issue of risk tolerance. And he made the point that we're -- when we're loo -- you know, he was asked the question, what type of event should we be protecting against? Should it be a one 1:700 event, like the floodway? Should it be a 1:100 event, like the DCAT used for private sector insurers in a -- in a monot -- in a competitive environment? Should it be the 1:20 event more commonly found in the statical literature?

And -- and the sage observation he made is that you should look at the proten -- the magnitude and the consequences of the potential impact that you're looking at. When you're looking at the devastating impacts to a city of six hundred and seventy thousand (670,000), or eight (8) -- seven hundred thousand (700,000), of a flood, both social and economically, then that's when you should be looking, as the province did to its credit, for protection against a 1:700 year event because the consequences are so high.

If you're looking at an issue relating to corporate solvency and protecting ratepayers in a competitive marketplace from having their insurer go under, you should be setting aside enough protection, arguably, for 1:100 year event. When you're looking at an event which is really about excessive rate increases in the face of a significant adverse non-rare -- rarely occurring event, Dr. Simpson's advise, Professor Simpson's advise, which our clients endorse, is you should be setting aside roughly enough protection for a 1:20 year event. It's not that you don't want a significant amount of protection, but the tradeoffs in terms of excess protection, in our client's perspective, outweigh the benefits.

So the -- the point our clients make is that when the DCAT is employed in a private sector competitive environment, looking at a plausible 1:100 event scenario, it's perfectly understandable while -- why that approach could be taken in that environment. But when you're looking at a monopoly in a -- in an environment such as Manitoba Public Insurance, then that level of risk tolerance is excessive, certainly in our client's perse -- respectful view.

And at page 51, we -- we put this question to MPI three (3) separate times before it was answered. And we asked:

"Is it your professional judgment
that in order to significantly
protect ratepayers against rate shock
you have to set up reserves that
protect them from the possibility of
1:100 -- 100 year events?"

We asked it once, it was pretty clear. We asked it again, there was a brief pause. And then finally, what -- in what appeared to be reluctantly, we got the answer from MPI, from Mr. Johnston: "Yes, I believe that is true."

And our clients understand why MPI would be reluctant to give that answer, because really when you think about the RSR, really is that the type of event we're trying to protect against?

Our clients certainly would not recommend a 1:100 level of protection for -- for rate protection. From their perspective it is not fair for those on modest or fixed inc -- fixed incomes, and it is over protection given the magnitude of the risk.

And certainly our clients asked this question, asking the Corporation whether they'd ask Manitoba seniors whether they would like to keep their -- their money in the Corporation's retained earnings to protect them against a 1:100 year event. And obviously the Corporation hadn't tested that proposition; we wish they would.

At page 53 our clients have some comments about Professor Simpson and his supporting team. This panel has had the opportunity to judge Professors -- Professor Simpson's demeanour and his evidence, and certainly our client found him to be a candid and thoughtful witness, and we hope the Board will make a similar finding. And it's important to understand where Professor Simpson came from. And -- and if you think right from the start, he started with that discussion of what -- what do we mean by modern statistical risk analysis? And he started out with that old probability distribution that makes all our eyes roll, but it's real important: a concept that we should have defined risk tolerances; our analysis should be based on relevant evidence, not -- not any scenario we can grab from the sky; and a tro -- transparent replicable, R-E-P-L-I-C-A-V-L (sic) process.

And Professor Simpson brought a rich experience, in our clients submission, to this -- this tribunal. He drew from diverse sources: his prior experience with MPI, his extensive literature review, his -- his extensive consulting practice, and his experience with other Crowns. And he was supported, as our clients certainly believe any future DCAT analysis should be, by an interdisciplinary team.

Go back to his written evidence, if you have the time; look at his assessment of the various methodologies. Our clients are confident you will conclude his analysis was not results driven; there was a candid assessment of the various methodologies. And you -- our clients are confident you will find, that Professor Simpson was really focussed on moving an evidence-based modern statistically risk assessment practice discussion forward. He was helping -- focussed on helping moving the dialogue forward, suggesting the technical conference, suggesting ways to improve the MPI methodology.

I was very tempted but I thought I would -- a -- challenge your patience, to provide some excerpts from the cross-examination of Professor Simpson, either by MPI or by the PUB. Our clients are confident; when you review that cross-examination, you will see his evidence only buttressed. And really, in a way, this morning's MPI Exhibit-32 and my subsequent cross-examination of a -- Mr. Johnston, buttressed Professor Simpson's views as well.

Think of this: Professor Simpson suggested using a -- a back of the envelope calculation that the impact of a 20 percent negative return in the range of 100 and -- $100 Million dollars. Look where Mr. Johnston reluctantly conceded, that result would be his estimate if it was gone through -- if it went the DCAT analysis. I think he started up at 186 million, 183 in terms of the budget variance analysis, or -- not the DCAT analysis, but by the time we finished that con -- conversation, he reluctantly conceded it would be less than 170 million. He reluctantly conceded it would be less than 150 million. By the time we got to less than 130 million, actually, he wasn't that reluctant; he was candid, and he appreciate his candour.

All that effort by MPI, MPI Exhibit-14, MPI Exhibit-27, MPI Exhibit-32, but yet, no DCAT analysis for modern decline in equity scenario. And certainly a concession, ultimately, closer to -- at -- less than 130 million, closer to Professor Simpson's back of the envelope calculation than the 180 million plus, we first heard from Mr. Johnston this morning.

Our clients, at page 54, have a few words about Mr. Johnston. And Mr. Johnston, I have to apologise, I spent a lot of time with you in -- in this proceeding, and at times, certainly I was a little sharp, for which I apologize. I don't mean "sharp" in sharp practices, but sharp in my tone, for which I apologise.

Generally speaking, our clients have generally - leaving aside a bit on ABO, other, and the DCAT analysis, found Mr. Johnston and his evidence on claims liabilities and risk analysis, in many ways, to be a breath of fresh air. Certainly his predecessor was a -- a very helpful witness, but our clients do appreciate a lot of what Mr. Johnston brought to this Hearing and we should -- should articulate that.

We think Mr. Johnston was generally very helpful in explaining his reasoning. We think he was candid, generally, in acknowledging the limits to -- with experience and the limits to the model, and we'll talk about that in a moment. And certainly from our clients perspective, they were encouraged by Mr. Johnston's willingness to look at ways to improve the DCAT analysis.

Our clients do wish that the energy expended on MPI-32 and MPI-14 would have been spent on a DCAT analysis for a minus 20 percent scenario. But, generally, they -- the certainly found a lot to commend Mr. Johnston for in this Hearing.

So is the DCAT, DCAT, ready for prime-time in setting their RSR? Earlier I adverted (sic) to the roots of the DCAT and I asked that cross-examination of Mr. -- in question of Mr. Johnston, in -- in -- just prior to the start of -- of Mr. Simpson's evidence, or Professor Simpson's evidence last thirt -- last Thursday, and he misunderstood my question and went on on a extensive response on -- about whether or not it -- the DCAT performed by MPI was a solvency test. Our client's point in asking that question was more subtle.

The client's point was it's important to understand where MPI and where other actuaries are coming from in -- in using the DCAT techniques. The DCAT in that type of analysis, our clients would suggest, did not arise primarily from responding to an RSR type scenario. It was really a tool to -- and certainly we commend the actuarial profession for developing it, to respond primarily, from our client's perspective, to a different type of risk experienced by -- by private sector firms in the competitive marketplace.

And you can see the roots of that in a -- in a variety of ways in -- in terms of the actuarial standards. You see that clau -- that conservative risk tolerance of 1:100 events, which you certainly wouldn't find in the academic literature. You see that tolerance for scenario tre -- testing, a tolerance that obviously Professor Simpson has some disdain for, which is not necessarily consistent with modern risk analysis, which is driven by empiricism and probability analysis.

And you can see -- and Professor Simpson made a brief reference to it, in a tolerance for more crude -- and I don't mean that in a pejorative, but more rough and extreme assumptions, the one that was produced by the external actuary that he spoke of, the 3 percent inflation scenario, not in the proceeding, but in past proceedings, with no management action presented by the Corporation's previous external actuary. And do not misjudge our client's words on this point, with the -- and I've got a misstatement here, within the context of private insurer, delete the word "monopoly", in a competitive marketplace -- place, these types of approaches, this kind of roughness, this -- this kind of ext -- extreme scenario in terms of risk tolerance may be entirely appropriate, but they may be less appropriate, and indeed they are less appropriate, in our client's submission, given the purposes of the RSR and the rigour of modern risk analysis.

And at page 56 our -- our clients hasten to make the point that that doesn't mean the DCAT cannot be adopted. And not just in this Hearing, but in his prior evidence in the last hearing Professor Simpson made it clear that he thought this could be a very useful tool if bounded by appropriate risk tolerances based upon assumptions of appropriate management action and based upon relevant reliable evidence. And he reiterated that point, that this is a tool that can be adopted, that can be moved.

But our clients want to highlight that there is a cultural shift in moving from a technique developed for a different environment to this environment, and you see it in extreme scenarios like the interest rate scenario presented by Mr. Christie a few years ago. You see it when Mr. Cheng talks about what he does -- what he normally does. When he talks about that, he's talking about the use of the DCAT for a different purpose of a private company in a competitive marketplace.

And certainly, from our client's perspective, that cultural adaptation issue helps to explain the puzzling decision of Mr. Johnston to use equity data from the 1930s without doing the most fundamental, the most basic of statistical tests, testing for a structural break using commonplace statistical techniques. And perhaps when dealing with a -- a solvency test you could have that kind of bias towards extremes, but from our client's perspective when you're looking at the more limited purpose of the RSR, it's not appropriate. And we note that still Mr. Johnston hasn't done that structural break test.

And in Exhibit 32 this morning he presented a table at page 2 which por -- purported to be, to use his language, "very similar to Professor Simpson's." But it was not. Professor Simpson's was a structural break analysis. It was based upon a specific break point -- breaking point in time. Mr. Johnston conceded this morning in cross-examination that that was not what he -- he had done. And certainly we expect that MPI will re-characterize that table in their closing submissions.

So going to page 57, is the DCAT model employed by MPI ready for prime time? "No", our clients would say. For one (1) reason, the model needs to be updated and validated. And our client and our consulting team, including the actuary and Professor Simpson, first became a little -- concerned is an overstatement, but a little less comfortable with the

DCA (sic) model when they identified in the information request process suspected inconsistencies in the equities output of the original DCAT estimate. Those were brought to the attention of MPI in an Information Request, and the Corporation, to its credit and to Mr. Johnston's credit, corrected the decline in equities scenario.

And again to Mr. Johnston's credit, in his direct evidence on day 1 of the Hearing, he was very candid in discussing some of the challenges in terms of their model as it currently was in the -- the ability of the existing financial model to handle the more complex modelli -- modelling scenarios, such as those produced by the DCAT or stochastic modelling.

So we appreciate his candour. And -- and we think that the concerns articulated in that Information Request and the Corporation's response suggests that there's a need to update and validate the model.

And certainly, the Board -- turning to page 58 -- if it wishes, can turn to its own order, PUB Order 5/12 -- and look at the discussion of the works of those econometricians, Professors Kuburski and Magee, in the hydro hearing. And -- and certainly our cli -- in our client's view -- and certainly a review of PUB-5-12 would reinforce that -- the model employs, by MPI, appears to be -- and I'm going to strike the word, "quite simplistic" and replace it with "somewhat simplistic."

Our clients articulated in cross-examination a concern with the decline in equities scenario, that it does not take account -- into account any changes in equity spread. And I do want to add, you see behind that statement, "mitigation is not the entire answer." Those are my notes to myself, those are not Mr. Johnston's words. But, certainly -- mitigation, certainly from our client's perspective, in terms of the offsetting impact of changes in int -- interest rates on liabilities and assets is -- is not a complete answer to this. And certainly our clients, in a improved DCAT model, would -- would expect a more robust model that took into account changes in equity spreads; a more sophisticated model than currently undertaken by MPI.

Our clients have con -- expressed the concern, perhaps implicitly, and perhaps Mr. Cheng explicitly, that with the fact that the DCAT does not pro -- provide a -- produce a full set of financials including balance sheets, statement of retained earnings, income statements and an MCT output. So that certainly is a -- a modelling change that our client sees as needed and -- and significant.

And at page 59, our clients want to highlight that their understanding of the current modelling done by MPI is that it provides limited insight into the correlation between factors. And we used the opportunity to discuss the relationship betwe -- between claims incurred and -- and clai -- claims expenses. And you see a -- a statement from Mr. Johnston:

> "Yeah, we -- we talked a little bit about this relationship between expenses and incurred, and I indicated that I struggled a little bit with what to assume in the DCAT."

And indeed, as you see in the -- the remainder of that page, the struggles were -- were reflected in -- in what was simply a judgmental assumption, rather than -- rather than a -- an assumption based upon actual correlation between factors.

Why does correlation matter? It matters profoundly because when you're -- when you're looking at the impacts of events while to the layperson, or the lay-lawyer, if you combine two (2) mix -- two (2) --

two (2) risks, you know, you simply add one (1) number to the other and you get a bigger -- a bigger risk. But that is -- is not proper mathematics, and that is not a -- not proper risk analysis.

Central to proper modern risk analysis is to look at the impact of -- of events and how they are correlated. And simply put, if they're negatively correlated, or if they're independent, then the impact upon the magnitude of the risk will be less than the additive impact.

And my -- I'm stretching my memory here, but even if they're not -- so I'll -- I'll leave it at that but correlation matters materially. And our client's observation is that correlation is -- is -- and -- and the understanding of correlation is not expressed in the DCAT modelling.

And if the panel looks at the -- the second largest scenario, the combined scenario, that's based on an assumption that the -- the growth in the two (2) factors is independent. But it's just an assumption, and certainly one would want to understand the actual relationship. And so I -- I can't do justice to correlation today, but those are factors of material concern for our clients.

So our client's recommendation is that

prior to the next hearing a technical conference be initiated to better explain the DCAT model, to validate it through sensitivity analysis, and to explore cost effective mechanisms to modernize the model.  And that certainly was a recommendation of Professor Simpson.

At page 61 -- and we've already answered this question -- we ask again:

> "Is it employed -- is the DCAT model employed by MPI ready for prime-time?"

And we -- our clients say, "no", emphatically no, because -- and -- because its risk tolerances, i.e., the 1:100 plausibility scenarios, are not appropriate for the limited purposes of the RSR. And so our client's recommendation on page 62 is that given the purpose of the RSR, to cushion the impact of unexpected non-recurring, we put in brackets recurring events], our clients reject the protection against one 1:100 events as excessive, and they suggest adopting a range around general accepted risk tolerances 1:20, and certainly they endorse wholeheartedly Professor Simpson's range 92.5 percent to 97.5 percent bound in the 95 percent.

And from our client's perspective, it's tough enough to tell a Manitoba senior who may be planning five (5) years ahead, maybe ten (10) years ahead, maybe optimistically if it's my in-laws twenty (20) years ahead -- they live to be around a hundred apparently -- but to set aside protection for a one 1:100 year event; that's a hard sell, and it's one, given the limited objectives of the RSR, our clients do not endorse.

MR. Chairman, I can -- I can keep taking you to the end, or if I might have a five (5) minute break just to -- and then we'll finish hard.

THE CHAIRPERSON: Let's take five (5) minutes, please.

--- Upon recessing at 3:02 p.m

--- Upon resuming at 3:09 p.m.

THE CHAIRPERSON: I believe we're ready to resume. Mr. Williams, to you again.

MR. BYRON WILLIAMS: Yes. Just -- we're at page 63 of the big outline. And in terms of -- if you might also have at hand, in terms of the CAC-12, the little excerpts handed out today, about four (4) pages in you should see a probability distribution -- actually two (2) of them and a headline: "The Decline in Equities Scenario."

(BRIEF PAUSE)

MR. BYRON WILLIAMS: So page 63 we again ask:

"Is the DCAT model employed by MPI ready for prime-time?"

And we submit that on our client's behalf that it's not, because the decline in equities scenario, and the combined scenario, reply -- rely upon inherently unreliable data. And a central point that certainly, our clients hope that Mr. -- Professor Simpson made is that when presenting this analysis, MPI didn't it -- not test the decline in equities data for a structural break, and certainly our clients consider that to be an important oversight.

And why do that? If the Court -- if the PUB is looking for some good reading, probably as opposed to listening to me, go back to the Corporation's response to CAC-1-3(b), it's noted at the bottom of page 63, and also 2.2. And -- and in those there's a bit of a dialogue between our clients and MPI, in terms of when might you not take history in -- into account. And MPI said, Well, maybe in hail, maybe if we -- if we found conclusive statistical evidence showing changes in the mean or variance of hail claims, or net hail loses.

So, that's really a -- a useful technique articulated in that discuss of hail scenarios by MPI. But that technique, the technique employed my Professor Simpson, was no employed by MPI, in terms of the decline in equity scenario. Test for structural break; see if within the data, that there's something statistically significant and different happening.

Another example the -- the -- one could look for, is look at how we look at our estimates of personal injury costs from Manitoba Public Insurance. We're looking back eighteen (18) years to the start of the -- or nineteen (19) years, to the start of the no-fault program. We don't go back to the -- to the start of the program, because there was the fundamental change that took place. And likewise, we commend MPI for that. You know, that data, there's inherent problems with the pre-no-fault data, and MPI, we commend it for recognising a structural break in the data and relying upon more current data.

Similarly, with the decline in equities, our clients say A) MPI should have tested for the structural break, B) they should have recognised it and used a technique consistent with modern risk analysis.

Does that dec -- structural break exist? Professor Simpson, if you look at the three (3) slides presented which are included in this Exhibit, addresses this issue in -- in three (3) different ways. First of all, he talks -- he starts with something to even Mr. Williams can understand: a probability distribution. And if you look at the dotted lines, that's the experience and the data in the modern era, 19 -- from -- from the 1950's.

And what can you conclude from that? Well, one thing that's clear from the probability distribution, subject to other statistical tests, is at the highs on the right side are not as high, and the lows on the left-hand side are not as low. So -- a -- just from the -- checking that from a probability distribution, suggesting that something different is happening.

If you flip to a -- the next page, the famous slide 7 from Professor Simpson's oral a -- the exhibit affixed to his oral evidence, here you see the test for a structural break. Looking at the ancient data, the data of the Roaring Twenties and the -- and the Great Depression versus the modern era, and Professor -- you -- when you look at the -- to the extreme right, you see that test of variance, or standard deviation, and a -- a -- Professor can -- Simpson concludes with very strong data, that this is a stat -- statistically significant structural break in the data.

On the next side, Professor Simp -- Simpson says, Look at it another way; If I haven't persuaded you with my picture and my sta -- statistic -- my standard deviation analysis, look at the fifth percentile event, and look at the profoundly different implication of choosing a fifth percentile event. For the modern era at the bottom, for the -- the Great Dep -- Depression/Roaring Twenties era, or for the entire time period. So that really is the heart of why Professor Simpson expresses grave concerns with the -- with the data pre -- pre-Pearl Harbour.

And just at page 65 of the outline, MPI at -- at one (1) point in time sought to argue that somehow they had moderated the influence, the -- of the pernicious pre-Pearl Harbour data by going to minus 40 percent instead of the fifth percentile event. But again all the observations worse than minus forty (40) took place prior to Pearl Harbour, and that was confirmed in cross-examination.

So why are our clients so concerned about this? Turning to page 66. It really goes back to a question asked by the scenario -- by the Chairperson, who I should not call "the scenario" -- and -- and think of Mr. Cheng's advise, and -- and think of -- that this dialogue about the DCAT and the analysis that is going to go on in the future, and Mr. Cheng is saying look at one (1) year scenarios. We heard Mr. Johnston talk about two (2) year, or three (3) year scenarios.

Well consider that if you're doing that decline in equities analysis based upon the -- the antiquated data prior to the structural break, the influence of that will be not just in the four (4) year cumulative return but a one (1) year analysis, a two (2) year analysis, a three (3) year analysis.

And the Chairperson asked a question not exactly along that -- this point, but he -- he asked about -- he asked about, you know, this will kind of continue. And -- and certainly our client's concern is using this pre-1950s data will taint any future decline in equities analysis, whether a one (1) year, two (2) year, three (3) or a four (4). From our client's perspective it will be the gift that keeps on giving, or in our client's per -- perspective the gift that keeps on skewing the analysis, not just for a cumulative four (4) year return but for other approaches.

At page 67, our -- we -- our clients ask:

"Well, is this just a debate between actuaries and -- and econometricians or microeconomists? Does -- is -- does one (1) of these professions purport to have a monopoly on modern risk analysis?"

And our clients certainly don't think so. And certainly they hope that Professor Simpson's advice to MPI was taken in the spirit of the advice of one (1) professional -- from a -- another high-level mathematician to -- to another.

And it is fair to say that there are a number of professions seeking to bring modern risk analysis techniques to the issue of risk in the context of a modern firm. Certainly we've seen tremendous improvements in the actuarial profession since the late 1980s. But it's also fair to say, and certainly Professor Simpson made this point, that much of the cutting edge lit -- literature and work flowing -- is flowing from applied econometrics and applied econ -- economics.

And presumably, it was in recognition of this point that in the Hydro hearing the Board, looking at risk analysis for another Crown Corporation, the Board chose to hire econometricians; not because they're better than actuaries, not because they're worse, but because they bring a unique valuable perspective. And certainly, our clients don't want this to be an actuary versus econometrician debate. That's certainly why Ms. Sherry was offered -- asked to provide her input to Professor Simpson as well. And -- and hopefully MPI will take it in the spirit of incorporating the best from an interdisciplinary perspective.

So our client's concerns with the DCAT as currently employed by MPI, certainly if -- if MPI is designing the DCAT to protect against no rate increases our clients consider that to be an over-restrictive prodec -- protection. They certainly believe that the model, while -- while developing impressively, is immature; that the risk tolerance as -- as expressed by the 1:100 event is extreme, and they are gravely concerned about the reliance on pre-structural break data.

So our client's recommendation, in terms of the DCAT, is that any D -- DCAT analysis in the future should employ standard statistical tests for structural breaks in the data, and certainly that the Corporation should use modern -- the modern period for the decline in equities scenario. And certainly I put an extensive discussion there, which is really a recapitulation of my prior submissions, or Professor Simpson's commentary, so I -- I won't elaborate on it.

Our clients -- so that's for today. What about in the future? And that's -- our clients discussed this at page 70. One (1) of the scenarios that our clients are particularly intrigued by by MPI is the combined scenario. Now, they don't believe it's reliable for the purposes of the RSR in this Hearing, because it's based on a 1:100 probability.

But there is some interesting stuff being presented, page 70 of the outline, Mr. Chairman, in that scenario. According -- if you go to kind of line 3 under the -- the bullet -- according to the amended DCAT report, page 21, the method involves running the stochastic models for claims incurred and equity returns to -- together, assuming they are independent -- that -- that relates to correlation which I spoke of earl -- earlier -- and choosing the first percentile of worst outcomes.

From our client's perspective, while they disagree with the -- the first percentile, and they look -- they -- they also think that consideration should be -- should be directed towards whether these events are actually independent, this is a promising methodology for future consideration of the combined effects of the most important risks faced by the Corporation.

And certainly, from our client's perspective, this is an approach that MPI should encourage to pursue, including an analysis of the correlations across risk categories. Again, one (1) of the concerns we've expressed with it in its current format is the 1:100 risk tolerance. The other one is the reliance on the pre-1950 data.

So generally, at page 71 we come to the 1:100 million, or 1:$200 million question, what RSR level for rate setting? And our clients, in trying to get their head around this question, tried -- tried to start with, Well, what are the different ranges that have been presented in this hearing? And it's a truly impressive -- or unimpressive range.

We've got Kopstein. We put roughly 77 million to one fifty-three (153). My Friend, Ms. Grammond, might have had a different number, but again, it's -- it's fairly clo -- close. It's got the value of incumbency and transparency, but really it fails to directly address the risk of MPI. Professor Simpson said that, Mr. Johnston has emphatically said that, and -- and MPI doesn't accept, so it's certainly not a long-term solution.

We've got the risk analysis, VaR, which at a two (2) year -- two point five (2.5) year time horizon, has a hundred and fifty-nine (159) to two hundred and twenty-eight (228), and historically that's a methodology that hasn't done that badly, but is volatile, as MPI points out, and again, MPI doesn't accept it.

Well, what about the DCAT? Well, from the DCAT we -- presented by MPI, we've got those scenarios of 80 million to 200 million. But first of all, all but one (1) scenario is based upon the 1:100 risk tolerance. And our clients certainly don't see that as an acceptable approach for the RSR. And again, from our client's perspective the decline in equity scenario is -- is not reliable as presented, and that again goes to the combined scenario.

So what about a DCAT based on modern equity data? We've made the very cautious statement here that it would be materially below upper limit of Kopstein and, i.e., less than 150 million. And Mr. Johnston can confirm today that at comparable level to the -- the PUB-2-32, it would be less than 130 million.

But the DCAT was not employed and the DCAT is an evolution. So frankly, our clients have some discomfort with all these approaches. And so what do they recommend? That the -- the PUB do not accept the DCAT as presented by MPI for purposes of the RSR; that the PUB direct MPI to develop a DCAT based on transparency, evidence-based justification of scenarios and stability, with risk tolerances bracketing the 95 percentile range, and certainly our clients think the DCAT could benefit from an interdisciplinary review.

Until we get the DCAT finalized, our clients think that the risk analysis in Kopstein should be presented annually as a check. They have cautiously picked an RSR upper limit of $150 Million dollars, but here's the important point: they're not seeking a rate rebate; they're saying lets recognise that this DCAT process, we're making strides, we're not your -- that -- that -- lets recognize the evolution of this process. And, you know, our clients think it's considerably less than 150 million; MPI thinks it upper -- you know, around 200 million.

In this Hearing, lets focus on moving the DCAT and risk analysis process forward. Lets worry a little bit less about the money; put that money in what Mr. Williams is suggested call the RSR Escrow Account.  Unless you're a hockey fan, you'll know that there's a -- you know --essentially between the NHL and the NHL Players Association, when they're trying to figure out what -- what the actual revenues were for the year, a portion of salaries are put aside into an escrow account.  Just notionally we chose that word. Perhaps, it's only my sick sense of humour.  But really to just say, protect it, keep it there so that we're not fighting about the -- about the dollar amount this year, that we're really trying to move the process ahead.

And again, lest my client chastize me, I want to emphasis our client is strongly of the view that -- that we have presented strong evidence, that the $200 Million dollar figure is -- is not the right figure, but recognizing that this a process in evol -- in evolution, that we're trying to a res -- a fresh regulatory start; they're not seeking a rate rebate and they're saying:  Just don't -- from our clients perspective they're recommending strongly that you not recommend the DCAT methodology of MPI.  Keep the money there, call it whatever you wish, and lets finalize this process, lets have a -- a good debate and put -- put this sucker with hope to bed next year.

At page -- and "sucker's" probably also a colloquial language that I'll strike from the record -- and wither AOCI -- and our client were -- client was quite interested with the -- the a -- recommendation of Mr. Cheng using AOCI for determining the threshold for failing the test of satisfactory future financial condition. At least that they understand it, and admittedly they haven't pres -- prepared a lot of time, spent a lot of time in this.

There are two (2) distinct issues using the AOCI for determining the threshold and certainly CA -- CA (Manitoba) (sic) is on preliminary basis, sympathetic for that. They haven't thought much about using AOCI for the purposes of rebate. They're certainly not recommending that at this point in time.

They're just -- so in terms of a recommendation, our client is -- is sympathetic to Mr. Cheng's advice, but frankly hasn't thought about it perhaps as carefully as it should, so they would certainly be -- will be expressing some preliminary sympathy for his views, but lea -- leaving some wiggle room to revisit that position next year.

Page 76. We're moving a -- just a -- a quick discussion in terms of investment. Really a critical issue, but sadly the record in this Hearing was not completed through no -- no party's fault. From our clients perspective, the incomplete record does not demonstrate that MPI and -- /finance, have achieved the optimal level of diversifying risk as compared to acceptable level of ret -- ret -- return. And like our friend Mr. Oakes, our client notes the irony that MPI really says it's biggest risk is from a decline in equities, but is asserting that, that's a problem over which the province has control. And that does beg, as Mr. Oakes asked, the question whether ratepayers should be on the hook for risks allegedly created by choices of the province, as well as flowing from adverse events in the market place.

So from our clients perspective, and recognizing that the record is imperfect, this is an issue that should be returned to next year, certainly -- and they would welcome the presence of a provincial witness.

The last two (1) issues that our clients wish to address are cost allocation and road safety. In terms of road safety, it probably doesn't belong in this part of the argument, but Mr. Williams got a little sleepy this morning and just put it in the wrong spot. Our clients would see that more pro -- properly coming under whether expenses are prudently and necessarily incurred, but you'll forgive me for that oversight.

At page 79, our clients provide essentially a highlight of the cost allocation issue from their perspective. And they start by expressing some disappointment in terms of what MPI's analysis and its consultants -- in terms of what it doesn't address.

In terms of -- while MPI has traditionally looked at this issue from a very narrow perspective of cost allocation, there's some very interesting concepts out there that our client is not satisfied that MPI has examined. From the in -- income tax world, there's the transfer pricing issue, looking at -- at fair and equitable relationships between affiliates. There's some in -- there's a good -- an interesting PUB decision relating to Centra Gas that is not referenced, and relating to affiliate code of conduct.

MPI candidly exam -- exe -- admits that there's no examination of the benefits of economies of scale as they may affect the costs experienced by Extension. And certainly no analysis of the overall fairness of the relationship, both on the revenue and cost side.

There can be no denial -- and Ms. -- Ms.

McLaren was candid in admitting this -- that there are material revenues flowing to MPI Extension from -- from its relationship to Basic. And certainly, again, our clients are disappointed that no effort has ma -- been made to understand or to capture this relationship.

I've mentioned the cost economies of scale point previously. We do note that it took some prodding by -- by cross-examination, but MPI reluctantly admitted that there may be benefits to Extension from the Basic's economy of scales.

At the bottom of page 79, our clients observe that a number of Crown's have chosen to structure their businesses in a variety of different ways, many -- many of them tending to be more transparent, and in a number of cases where the affiliate would have to pay market rates for the type of service provided. And one (1) is the use of Hydro's information technology by Centra and, again, another one is the relationship set out in the affiliate code of conduct in the Centra Gas decision.

On page 80, our clients note, as Ms. Grammond did this morning, that in terms of the allocator at par -- particular dispute, there are two (2) reasonable options, being the claims incurred allocator and the premiums written.

Page 81, we simply re-summarize issues where we -- we believe MPI could have reexamined.

At page 82, we do highlight Ms. McLaren's comments recognizing the advantages acc -- accruing to Autopac Extension in terms of revenue generating, by virtue of it being associated with Basic. And this is bolded at the bottom of this analysis.

At page 83, our clients again reiterate the evidence of Ms. Reichert and the assets and liabilities study in terms of a charge levied by Manitoba Hydro to Centa -- Centra for the use of information technology.

An encouraging part of the discussion, certainly from our client's perspective, was at page 84 where MPI seemed to our client to express some openness to what we consider to be an analogous approach: the recommendation of the Gartner Group in terms of charging for information technology services. And certainly, our client, if you're not getting the point already, is -- is not satisfied that the cost allocation methodology proposed by Deloitte satisfactorily explores the multiply integrated relationship between Basic and Extension.

And really, if you think of MPI's

presentation of that argument, it's really about, Well, Basic's better off having someone to share the costs with; not looking at the material benefits flowing to Extension from -- in terms of revenues; not looking at the material benefits, we would argue. MPI would reluctantly concede some benefits flowing from economies of scale.

So it's -- from our client's perspective an impoverished analysis, and certainly approaches like Gartner, which they appear to be suggesting charging for information technology services, that may put more transparency and more market-driven approaches into the analysis.

At page 86 we merely summarize really what is the standard cross-examination that is always done in cost allocation saying, you know what, I can't use any -- there are a variety of different reasonable ways to get to this answer, and certainly KPMG, to our understanding, has expressed the view -- or signed off on both the written premiums incurred and the claims incurred approach.

So from our client's perspective, the cost allocation analysis presented by MPI continues to be impoverished. Certainly, we look forward to it reporting back on changes -- on charges for the use of technology, and whether that makes -- can -- has the potential to make improvements in terms of cost allocation or efficiency.

If our clients had to chose between premiums written as an allocator or -- or claims incurred, they prefer premiums written. Here you can accuse them of self-interest. But more importantly, they see this as -- as more reasonable because within the limits of the impoverished cost allocation analysis, it more accurately captures the overall relationship than the cost allocator. And it does so because at least to a certain degree it takes into account the benefits inuring to Extension from the Basic monopoly in terms of revenues.

Our clients would be open to revisiting this issue from a broad -- broader perspective but if the Board out of weariness with the issue wants to put it to bed, certainly from our client's perspective, they would be supportive of the premiums written as the allocator.

The last major topic is road safety. And just for the new members of the Board, and Ms. McLaren discussed this I think in -- in my conversation with her on road safety, in a regular hearing you would see all sorts of Information Requests and cross-examination by CAC (Manitoba) about how are you measuring the performance of your -- of your -- your investments in road safety? Aren't you going to move up the budget for, you know, impaired driving or -- et cetera?

This year in recognition of the fact that the -- the Corporation has been doing a lot of soul searching and some -- some helpful consultation on this subject, our clients backed away from that more detailed examination, and -- and tried to approach it a little more conceptually.

And -- and like CAA, and you'll see this on page 88, our clients do start from a general starting point that investment in services such as infrastructure and policing should be paid for by tax dollars. But our clients want to emphasize, and -- and -- that they're open to persuasion on this, but open to persuasion based upon sound empirical evidence. And open to evidence supporting justification suggesting a clear business case for cost savings to ratepayers, and to mitigating the social and economic cost of accidents.

And it's perhaps helpful to remind the Board that a lot of this discussion, the last time we had a serious discussion about infrastructure, was at our client's instigation in the middle of the last decade when over at a half decade ago they -- they pushed MPI to examine more carefully whether it should be investing more in enforcement and infrastructure; not to endorse those ideas but to try and expand the -- the dialogue before this Commission.

At pages 1,002 through 1,005 our clients summarize through -- through the helpful evidence of Ms. McLaren the many different visions for MPI in terms of road safety. And it was -- it was -- there's some really impressive work done here, but our clients ask the question: Is -- they make the observation that MPI has been invited to do many things, and -- and they raise the question: Is -- is it being asked to do too many things?

And certainly, as we move forward in this discussion, that's something our clients will keep at the forefront. There are some expectations being raised in the -- in the community in terms of MPI and -- and that's not a -- not a bad thing.

And our clients are confident that over time they'll -- they may be up to the task, but it's important to make sure that -- that we're not asking too much of MPI as well.

And why not? Well, at page 90 there's a

risk to ratepayers, certainly, that spending can certainly get out of control and -- and there's also a risk, though not articulated on this page, that the dissipating the Corporation's energies on too many rolls may -- may risk minimizing the -- the positive contribution it can make.

At page 91 our clients raise what they consider to be some threshold questions in terms of MPI going forward. In any proposal being brought forward by MPI, our clients will ask: Is there a measurable positive contribution to ratepayers and to mitigating the material social costs of accidents?

They'll ask, as CAA did this morning: Is MPI best suited to delivering the programming? They will ask: Is MPI currently equipped to make judgments about the best use of resources, those difficult al -- allocation issues? And certainly our clients will explore more robustly, if MPI moves more aggressively down this path, what mechanisms they have in place to test the costs versus the benefits of these proposals.

They'll also ask that critical question: Will investments have broader social implications with the risk of leading to a societal mis-allocation of resources, recognizing that we've -- we've got to look at the MPI expenditures within the broader context of societal expenditures.

At page 92 our clients identify what they consider to be some key missing information. The first one may be more our client's fault than -- than -- or not -- maybe they're our client's legal counsel's fault than -- than MPI's, but our clients have not, certainly in our -- through their focus groups and their advisory groups have learned more about some interesting services that MPI does deliver.

And one, which again, CAA adverted to this morning was that mature driver's workshop, which is apparently available free. And our clients certainly are of the view that -- that that's a program with a significant potential, not just for seniors, but for new Canadians, poor drivers like Mr. Williams, and certainly that there's some opportunities there.

And there's also, from our client's perspective, it's really unclear who actually is doing what. And we asked MPI this question on behalf of our client's at page 1193 of their -- of the transcript:

"Is there some sort of baseline or survey of who's doing what and how much they're investing to date?"

And Ms. McLaren said, "Not to my knowledge." And our clients think that that's an important threshold piece of information as this panel and MPI moves forward.

So from our client's perspective, in terms of road safety, they certainly would in -- suggest that MPI should be encouraged to continue its discussions and consultations in this regard; that it should be asked to produce baseline surveys of who is doing what and what data is available - and certainly we've seen some of that in some past proceedings - in developing its proposals that it be directed to address some of those hard questions that our clients asked previously.

At page 94 there is a -- a very brief discussion of the flat rate for PIPP. And certainly our clients are generally supportive of the views expressed by MPI, that that should not be accepted at this time largely for the reasons articulated by MPI at the pages are -- enumerated, page 1231 to 1234 of the cross-examination by CMMG.

At page 95 our clients note that they will be applying for a cost award. Of note to the Board, they would observe that there's a grate (sic) in SM 2.7, page 7, there's a statement of what regulatory appeal costs are. And certainly, they're not insignificant, amounting in our client's estimate of something like 0.4 percent of Basic costs over the forecast period. But our clients think it's also -- that's pretty good bang for the buck. And that while we must always be vigilant, it is a relatively small cost given the value provided by these proceedings.

At page 96, our clients say -- say thank you, certainly, to the panel and to the court reporter, to -- to the MPI witnesses and their legal counsel for facilitating the introduction of exhibits in a less cumbersome manner. To Board counsel who, every year, raises the threshold for all others in the hearing in terms of the quality of her cross-examination and her -- to her excellent advisors. And certainly to the Board secretary, who has to put up with Mr. Williams' constant forgetting of the exhibit number.

Mr. Chairman, subject to any questions of the panel, those are our client's submissions.

THE CHAIRPERSON: Thank you very much for the -- the very exhaustive examination of the issues and the recommendations. So thank you very much. That was quite an interesting presentation, so I know you worked on it quite late so thank you for taking the time to do that.

Do you have any questions?

This is a minor point, but looking at

page -- Mr. Williams, looking at page -- specifically at page 68. And it has to do with the DCAT, of course. The -- and the -- I guess the statement was to the effect that the definition of no rate increase is over restrictive. And now I'm thinking -- thinking for example of my brother driving -- driving, you know, leading his life quite peacefully in his hometown and he -- he advised that the portfolio held by Manitoba Public Insurance has taken a dive.

And he wants -- you know, we advised -- the PUB makes the decision that they need to increase their rates to -- to my brother because they made a mistake in -- in -- on Broadway. So -- so, in that context, my -- my -- I expect my brother would say, why the hell should we be paying for a mistake that was made by -- by a portfolio manager at Broadway?

So could you -- could you explain your thinking there?

MR. BYRON WILLIAMS: What I think is probably less relevant than what my client thinks, which is -- but as I understand my client's thinking just, first of all, our client did raise a similar concern to your -- your brother. I'm going to -- on -- just so -- and the point may have been lost in your -- given my exhaustive presentation.

But at page -- at 7 -- at page 76, if you see the bracketed statement. Our client pointed out the irony that:

"MPI is claiming that the RSR needs to be over 200 million to protect ratepayers against risk flowing from equities which it -- it asserts province has control over. And it begs the question whether ratepayers should be on the hook for risks allegedly created by choices of province."

So certainly our clients have some sympathy for that point. If you stay on that page for just a second, though, from our client's perspective -- this is, again, on page 76 and then I'll go back to your question, Mr. Chairman. From our client's perspective, though, even in this hearing who controls what is -- is not perfectly clear. And we highlighted it and I should have summarized this in my statement.

A very interesting statement by Mr. Johnston, at page 9 -- 985 of the transcript related more to interest rates than equities. But, again, going to assets and liabilities:

"The Corporation wouldn't stand still

as interest rates gradually rise. We
would expect it to know -- it to
[comma], you know [comma], manage our
[hyphen] -- our asset -- assets and
liabilities appropriately."

And certainly that statement caught our client's eyes as being kind of an -- an outlier from the rest of the me -- message that -- that this is all done on -- on Broadway. So, while our client has some sympathy for your -- your brother-in-law or your brother -- brother's position, and that's why they said, "This begs the question." Our clients aren't satisfied where the record lies on -- on this is and -- and so that's just a partial response.

In terms of the actual statement you -- you pointed this panel to, the definition of no rate increases over restrictive, what my client meant by that, at least as I understood it, is when our client conceives of the rate stabilization reserve, let's leave aside the decline in equities scenario for just a second, and let's move it to a grievous $80 million impact in claims liabilities, a one (1) time only non recurring event, whatever that would be, our client doesn't see the purpose of the RSR necessarily as protecting them absolutely from any rate increase.

It's -- it's a muting (phonetic) im -- impact.

So -- and --and why does our client take that perspective? I guess it goes back to that balance between risk and -- and opportunity costs. And -- and the idea that if you're going to sock away so much money that -- that, you know, you're protecting against a 1:100 event so that they'll be no rate increase flowing from it, well maybe -- maybe that's a -- maybe that's a bit overly restrictive. That's not the kind of tradeoff that -- that my client is supportive of.

So that I think is where that specific statement flows from, Mr. Chairman -- Chairperson.

THE CHAIRPERSON: I believe there are no further questions from the panel, so unless there's some other business to address before we adjourn today, I'm -- I don't think there's any thing else to address, so we are going to adjourn for today and we'll meet again on Thursday at 9:30. And I guess from the -- we're going to hear the concluding comments from MPIC.

So have a good evening, everyone, and we'll see you again on Thursday.

--- Upon adjourning at 3:52 p.m.

Certified Correct,

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Cheryl Lavigne, Ms.